NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET CHANGE 4

NCUA 8006 (M3500) DATE: May 1997

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED

This is Change 4 to the National Credit Union Administration Rules and Regulations (Revised April 1996).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised April 1996) in the following manner:

a. **Section 701.1** Revised references to Federal credit union chartering, field of membership modifications, and conversions.

b. **Section 704 Corporate Credit Unions.** Revised entire part.—**New rule effective on January 1, 1998.**

c. **Section 709.5 Payout Priorities in Involuntary Liquidation.** Revised paragraphs (b)(7) and (b)(8), and added paragraph (b)(9).—**Change effective January 1, 1998.**

d. **Part 741 Requirements for Insurance.** Added Section 741.219 Investment requirements. **Effective January 1, 1998.**

e. **Section 790.2 Central and Regional Office Organization.** Paragraph (b)(4) revised to reflect mission and corresponding name change of the Asset Liquidation and Management Center (ALMC). The new name is the Asset Management and Assistance Center (AMAC).

f. **Section 792.2 Information made available to the public and requests for such information.** Paragraph (f) revised to reflect name change of the ALMC to AMAC.

g. This Change also reflects corrections to typing errors.

2. **INSTRUCTIONS:**

a. Your April 1996 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xi	i–xi
701–1 thru 701–18	701–1 thru 701–18
	704A–1 thru 704A–19*
709–3 thru 709–7	709–3 thru 709–7
741–7	741–7
790–1 thru 790–4	790–1 thru 790–4
792–1 thru 792–2	792–1 thru 792–2

b. Included with this Change are the Federal Register published preambles to the above changes. (The preambles are not part of the rules, but you may find them useful for explanatory purposes.)

*Retain pages 704–1 thru 704–11 as this rule remains in effect until December 31, 1997.

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET CHANGE 3

NCUA 8006 (M3500) DATE: January 1997

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED

This is Change 3 to the National Credit Union Administration Rules and Regulations (Revised April 1996).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised April 1996) in the following manner:

a. **Section 701.21 Loans to members and lines of credit to members.** Revised first sentences in paragraphs (d)(1) and (d)(4).

b. **Section 707.1 Authority, purpose, coverage, and effect on state laws.** Revised first sentence of paragraph (c).

c. **Appendix C to Part 707—Official Staff Interpretations.** Added new paragraph 3 under § 707.1(c).

d. **Section 745.200 General.** Revised paragraphs (b) and (d).

e. **Section 747 Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations.** Added **Subpart K—Inflation Adjustment of Civil Monetary Penalties.**

f. This Change also reflects corrections to typing errors.

2. **INSTRUCTIONS:**

a. Your April 1996 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xi	i–xi
701–11 thru 701–12	701–11 thru 701–12
701–15 thru 701–16	701–15 thru 701–16
707–1 thru 707–2	707–1 thru 707–2
707–31 thru 707–55	707–31 thru 707–55
745–15 thru 745–17	745–15 thru 745–17
747–33 thru 747–34	747–33 thru 747–35

b. Included with this Change are the Federal Register published preambles to the above changes. (The preambles are not part of the rules, but you may find them useful for explanatory purposes.)

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET CHANGE 2

NCUA 8006 (M3500) DATE: November 1996

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED

This is Change 2 to the National Credit Union Administration Rules and Regulations (Revised April 1996).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised April 1996) in the following manner:

a. **Section 701.34 Designation of low-income status; receipt of secondary capital accounts by low-income designated credit unions.** Revised paragraphs (a)(1), (b)(2) and (c).

b. **Section 705.3 Definitions.** Revised paragraph (b) to clarify that student credit unions are excluded from participation in the Community Development Revolving Loan Program.

c. **Section 705.5 Application for Participation.** Revised paragraph (b)(1).

d. **Section 705.7 Loans to Participating Credit Unions.** Revised paragraph (a) by adding "in the aggregate."

e. **Section 705.10 Technical Assistance.** Revised entire paragraph.

f. **Part 711 Management Official Interlocks.** Revised entire Part.

g. **Part 760 Loans in Areas Having Special Flood Hazards.** Revised entire Part.

h. **Section 791.6 Subject Matter of a Meeting.** Revised paragraphs (a) and (b) to allow for items to be placed on the Board agenda by the Chairman or at the request of two Board members.

Included with this change are the Federal Register published preambles to the above changes are well as the preambles to the rules contained in Change 1 (September 1996). The preambles were inadvertently omitted from Change 1. (The preambles are not part of the rules, but you may find them useful for explanatory purposes.)

2. **INSTRUCTIONS:**

a. Your April 1996 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xi	i–xi
701–29 thru 701–30	701–29 thru 701–30
705–1 thru 705–3	705–1 thru 705–3
711–1 thru 711–5	711–1 thru 711–5
760–1 thru 760–3	760–1 thru 760–4
791–1 thru 791–7	791–1 thru 791–7

NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET CHANGE 1

NCUA 8006 (M3500) DATE: September 1996

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED

This is Change 1 to the National Credit Union Administration Rules and Regulations (Revised April 1996).

1. **PURPOSE.** To update the National Credit Union Administration Rules and Regulations (Revised April 1996) in the following manner:

a. **Section 701.1—**Revised references to Federal credit union chartering, field of membership modifications and conversions.

b. **Section 701.12—Supervisory committee audits and verifications.—**Revised paragraphs (a)–(c), redesignated paragraphs (d) and (e) as (g) and (h) and added new paragraphs (d), (e), and (f). New Section 701.12 does not become effective until 12/31/96. Compliance before that date is voluntary. The rule as it appears in NCUA's April 1996 publication is effective until 12/31/96. You may wish to retain that page for reference until 12/31/96.

The amendments to this regulation will not have a significant impact on a credit union which meets its supervisory committee audit obligations in any of the following ways:

- The credit union's supervisory committee performs the audit itself.
- The credit union's internal auditor performs the audit.
- The supervisory committee recruits a member or volunteer who performs the audit (i.e., the member or volunteer is not in the business of performing compensated audits for credit unions).
- The supervisory committee obtains an opinion audit.

If the supervisory committee itself or its uncompensated designated representative performs the supervisory committee audit as prescribed in § 701.12(c)(5)(i)(D), the following portions of the proposed regulation will not apply to the supervisory committee audit:

- § 701.12(c)(4)—Increased scope requirements in designated areas;
- § 701.12(c)(5)(i)(A–C)—Opinion audits and agreed-upon procedures in relation to compensated auditors; and
- § 701.12(d)—Engagement letter requirements.

c. **Section 701.32—Payments on Shares by Public Units and Nonmembers.**—Revised section heading and paragraphs (a) and (b)(1). Moved paragraph (d), to new Section 701.34.

d. **Section 701.34—Designation of low-income status; receipt of secondary capital accounts by low-income designated credit unions.**—Redesignated paragraph (d) of § 701.32 as paragraph (a)(1) of § 701.34. Revised third sentence of newly designated paragraph (a)(1) and added new paragraphs (b) and (c), and added an Appendix.

e. **Section 703.5—Prohibitions.**—Introductory language and paragraphs (g) and (j) were printed incorrectly when the new set of Regulations was distributed in April 1996. The corrected sections are included with this change.

f. **Section 705.3—Definitions.**—Revised paragraph (b). Updated citation to new Section 701.34(a)(1).

g. **Section 709.5—Payout Priorities in Involuntary Liquidation.**—Revised paragraphs (b)(6) and (b)(7). Added new paragraphs (b)(8) and revised last sentence of paragraph (e).

h. **Section 741.204—Maximum public unit and nonmember accounts, and low-income designation.**—Revised reference in third sentence of paragraph (b) to read § 701.34(a). Added new paragraph (c).

i. **Section 747—Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations.**—Revisions to §§ 747.1(c)(2); 747.6(c)(3); 747.8(b); and 747.9(a) and (b); and added new § 747.9(e). Revised §§ 747.11(c)(2) and (d); 747.12(a), (c)(1), (c)(2), and (c)(3); 747.20(a); 747.24(a) and (b); 747.25(a), (b), (e), and (g); 747.33(a); 747.34(a) and (b)(1). Redesignated § 747.35(a)(3) as 747.35(a)(4); added new paragraph (a)(3), and revised paragraph (b). Revised §§ 747.37 section heading and (a)(1); and 747.38.

j. **Part 790—Description of NCUA; Requests for Agency Action.**—Revised § 790.2(b)(5) and (6). Deleted description of and references to the *Office of the Controller.* Added description of and references to the *Office of Chief Financial Officer.* Revised descriptions for the *Office of Examination and Insurance,* and *NCUA Central Liquidity Facility.*

k. This Change also reflects corrections to typing errors.

2. **INSTRUCTIONS:**

a. Your April 1996 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–x	i–xi
700–1 thru 700–2	700–1 thru 700–2
701–1 thru 701–28	701–1 thru 701–33
703–3 thru 703–4	703–3 thru 703–5
705–1 thru 705–2	705–1 thru 705–2
709–3 thru 709–4	709–3 thru 709–4
741–5 thru 741–7	741–5 thru 741–7
747–1 thru 747–34	747–1 thru 747–34
790–1 thru 790–4	790–1 thru 790–4

b. Enclosed with Change 1 are the Federal Register published preambles to the rules contained in this change. The preambles are not part of the rules, but you may find them useful for explanatory purposes.

NCUA

Rules and Regulations

Revised April 1996

National
Credit Union
Administration
Alexandria, VA 22314–3428

NCUA 8006 M3500

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*THESE PARTS APPLY TO FEDERALLY INSURED STATE-CHARTERED CREDIT UNIONS AS WELL AS FEDERAL CREDIT UNIONS

**This part becomes effective January 1, 1998. At that time the current part 704 (pages 704–1 thru 704–11) can be removed.

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**This section becomes effective January 1, 1998.

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Part 700

Definitions

§ 700.1 Definitions.

As used in this chapter:

(a) "Act" means the Federal Credit Union Act (73 Stat. 628, 84 Stat. 944, 12 U.S.C. 1751–1795(k)).

(b) "Administration" means the National Credit Union Administration.

(c) "Board" means the National Credit Union Administration Board.

(d) "Credit Union" means a credit union chartered under the Federal Credit Union Act or, as the context permits, under the laws of any State.

(e) "Regional Director" means the representative of the Administration in the designated geographical area in which the office of the Federal credit union is located.

(f) "Regional Office" means the office of the Administration located in the designated geographical area in which the office of the Federal credit union is located.

(g) "State" means a State of the United States, the District of Columbia, any of the several Territories and possessions of the United States and the Commonwealth of Puerto Rico.

(h) "Remaining maturity" is the time period from the date of the required reserve transfer to the stated date of maturity of the instrument.

(i) For the purpose of establishing the reserves required by Section 116 of the Federal Credit Union Act, all assets except the following shall be considered risk assets:

(1) Cash on hand.

(2) Deposits and/or shares in federally or stated insured banks, savings and loan associations, and credit unions that have a remaining maturity of 5 years or less.

(3) Assets that have a remaining maturity of 5 years or less and are insured by, fully guaranteed as to principal and interest by, or due from the U.S. Government, its agencies, the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association. Collateralized mortgage obligations that are comprised of government guaranteed mortgage loans shall be included in this asset category.

(4) Loans to other credit unions that have a remaining maturity of 5 years or less.

(5) Student loans insured under the provisions of Title IV, Part B of the Higher Education Act of 1965 (20 U.S.C. 1071, et seq.) or similar state insurance programs that have a remaining maturity of 5 years or less.

(6) Loans that have a remaining maturity of 3 years or less and are fully insured or guaranteed by the Federal or a state government or any agency of either.

(7) Shares or deposits in a corporate credit union that have a remaining maturity of 5 years or less, other than Membership Capital Share Deposit accounts as defined in Part 704. A corporate credit union is defined as a credit union that:

(i) Is operated primarily for the purpose of serving other credit unions;

(ii) Is designated by the National Credit Union Administration as a corporate credit union; and

(iii) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union.

(8) Common trust investments, including mutual funds, which deal exclusively in investments authorized by the Federal Credit Union Act that are either carried at the lower cost or market, or are marked to market value monthly.

(9) Prepaid expenses.

(10) Accrued interest on non-risk investments.

(11) Loans fully secured by a pledge of shares in the lending Federal credit union, equal to and maintained to at least the amount of the loan outstanding.

(12) Loans which are purchased from liquidating credit unions and guaranteed by the National Credit Union Administration.

(13) National Credit Union Share Insurance Fund Guaranty Accounts established with the authorization of the National Credit Union Administration under the authority of Section 208(a)(1) of the Federal Credit Union Act.

(14) Investments in shares of the National Credit Union Administration Central Liquidity Facility.

(15) Assets included in numbered items 2, 3, 4, 5, 6, and 7, with maturities greater than 5 years are exempt from risk assets if the investment is being carried on the credit union's records at the lower of cost or market, or are being marked to market value monthly.

(16) Assets included in numbered items 2, 3, 4, 5, 6, and 7 with remaining maturities greater than 5 years are exempt from risk assets provided they meet the following criteria, irrespective of whether or not the asset is being carried on the credit union's records at the lower of cost or market, or are being mared to market value monthly:

(i) The interest rate is reset at least annually.

(ii) The interest rate of the instrument is less than the maximum allowable interest rate for the instrument on the date of the required reserve transfer.

(iii) The interest rate of the instrument varies directly (not inversely) with the index upon which it is based and is not reset as a multiple of the change in the related index.

(17) Fixed Assets as defined in Section 701.36(b).

(18) Deposit in the National Credit Union Share Insurance Fund representing a federally insured credit union's capitalization account balance of one percent of insured shares.

(j)(1) Insolvency. A credit union will be determined to be insolvent when the total amount of its shares exceeds the present cash value of its assets after providing for liabilities unless:

(i) It is determined by the Board that the facts that caused the deficient share-asset ratio no longer exist; and

(ii) The likelihood of further depreciation of the share-asset ratio is not probable; and

(iii) The return of the share-asset ratio to its normal limits within a reasonable time for the credit union concerned is probable; and

(iv) The probability of a further potential loss to the insurance fund is negligible.

(2) For purposes of this section, the following definitions are used:

(i) "Cash value of assets." Recorded value will be considered the cash value of any asset account providing accepted accounting principles and practices are followed and the provisions of law, regulation, and bylaws are met.

(ii) "Liabilities." Recorded liabilities which are due and payable, excluding shares of members and nonmembers, are considered liabilities.

(k) For purposes of determining the amount required to be transferred to regular reserves under Sections 116 and 201(b)(6) of the Federal Credit Union Act, "gross income" means the total of the operating income accounts reduced by the following.

(1) Dividends received on shares in the National Credit Union Administration Central Liquidity Facility;

(2) Dividends received by credit unions on special share accounts held in Agent members of the Central Liquidity Facility authorized by § 725.7 of this chapter; and

(3) Interest received by an Agent member of the Central Liquidity Facility to the extent of interest paid to the Facility by the Agent member. In the case of an Agent member of the Central Liquidity Facility that is a group of central credit unions—

(i) Interest received by the Agent group representative, as defined in § 725.1(b) of this chapter, to the extent of interest paid to the Facility by the Agent group representative; and

(ii) Interest received by each central credit union in the Agent group (other than the Agent group representative) to the extent of interest paid by each such central credit union to the Agent group representative on Agent group representative loans, as defined in § 725.1(b) of this chapter. Nonoperating gains and losses are not included in gross income.

Part 701

Organization and Operations of Federal Credit Unions

§ 701.1 Federal credit union chartering, field of membership modifications, and conversions.

National Credit Union Administration practice and procedure concerning chartering, field of membership modifications, and conversions are set forth in Interpretive Ruling and Policy Statement 94–1 Chartering and Field of Membership Policy (IRPS 94–1) as amended by IRPS 96–1. Copies may be obtained by contacting NCUA at the address found in § 792.2(g)(1) of this chapter. The combined IRPS are incorporated into this section.

§ 701.2 Incorporation by reference.

(a) The publication used by Federal credit unions, which is identified in this chapter, is hereby incorporated by reference pursuant to 5 U.S.C. § 552(a)(1) and the regulation issued thereunder.

(b) Copies of the publication prescribed in this chapter may be obtained on request addressed to National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

(c) Revisions or amendments of the publication may be issued from time to time by the National Credit Union Administration. A historic file of such amendments or revisions is maintained and made available for inspection at the National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

(d) The publication listed below is hereby incorporated by reference:

(1) Federal Credit Union Bylaws. (Approved by the Office of the Federal Register through June 30, 1982.)

(e) Copies of this publication are on file with the Director, Office of Federal Register, National Archives and Records Service, General Services Administration, Washington, D.C. 20408. The text of any changes in said publication will be filed with the Director, Office of the Federal Register, and a notice thereof will be periodically published in the Federal Register.

§§ 701.3–701.5 [Reserved]

§ 701.6 Fees paid by Federal credit unions.

(a) *Basis for assessment.* Each calendar year or as otherwise directed by the Board, each Federal credit union shall pay to the Administration for the current National Credit Union Administration fiscal year (January 1 to December 31) an operating fee in accordance with a schedule as fixed from time to time by the National Credit Union Administration Board based on the total assets of each Federal credit union as of December 31 of the preceding year or as otherwise determined pursuant to paragraph (b) of this section.

(b) *Coverage.* The operating fee shall be paid by each Federal credit union engaged in operations as of January 1 of each calendar year, except as otherwise provided by this paragraph.

(1) *New charters.* A newly chartered Federal credit union will not pay an operating fee until the year following the first full calendar year after the date chartered.

(2) *Conversions.* A state chartered credit union that converts to Federal charter will pay an operating fee in the year following the conversion. Federal credit unions converting to state charter will not receive a refund of the operating fee paid to the Administration in the year in which the conversion takes place.

(3) *Mergers.* A continuing Federal credit union that has merged with another credit union will pay an operating fee in the following year based on the combined total assets of the merged credit union and the continuing Federal credit union as of December 31 of the year in which the merger took place. For purposes of this requirement, a purchase and assumption transaction wherein the continuing Federal credit union purchases all or essentially all of the assets of another credit union shall be deemed a merger. Federal credit unions merging with other Federal or state credit unions will not receive a refund of the operating fee paid to the Administation in the year in which the merger took place.

(4) *Liquidations.* A Federal credit union placed in liquidation will not pay any operating fee after the date of liquidation.

(c) *Notification.* Each Federal credit union shall be notified at least 30 days in advance of the schedule of fees to be paid. A Federal credit union may submit written comments to the Board for consideration regarding the existing fee schedule. Any subsequent revision to the schedule shall be provided to each Federal credit union at least 15 days before payment is due.

(d) *Assessment of Administrative Fee and Interest for Delinquent Payment.* Each Federal credit union shall pay to the Administration an administrative fee, the costs of collection, and interest on any delinquent payment of its operating fee. A payment will be considered delinquent if it is postmarked later than the date stated in the notice to the credit union provided under § 701.6(c). The National Credit Union Administration may waive or abate charges or collection of interest if circumstances warrant.

(1) The administrative fee for a delinquent payment shall be an amount fixed from time to time by the National Credit Union Administration Board and based upon the administrative costs of such delinquent payments to the Administration in the preceding year.

(2) The costs of collection shall be the actual hours expended by Administration personnel multiplied by the average hourly salary and benefits costs of such personnel as determined by the National Credit Union Administration Board.

(3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and Loan Rate in effect on the date when the payment is due as provided in 31 U.S.C. § 3717.

(4) If a credit union makes a combined payment of its operating fee and its share insurance deposit as provided in § 741.4 of this chapter and such payment is delinquent, only one administrative fee will be charged and interest will be charged on the total combined payment.

§§ 701.7–701.11 [Reserved]

§ 701.12 Supervisory committee audits and verifications.

SECTION 701.12 BECOMES EFFECTIVE ON 12/31/96. The section as it appears in the April 1996 publication is effective until that time.

(a) *Definitions.* As used in this chapter:

(1) *Agreed-upon procedures engagement* refers to the performance by an independent, licensed certified public accountant of an engagement in which the scope is limited to applying specified agreed-upon procedures to one or more specified elements, accounts or items of a financial statement. Such procedures are insufficient to express an opinion regarding either the financial statements taken as a whole, or the specified elements, accounts or items under examination.

(2) *Compensated auditor* refers to any accounting/auditing professional, excluding credit union employees, who is compensated for performing more than one compensated supervisory committee audit and/or verification of members' accounts, or opinion audit, per calendar year.

(3) *Financial statements* refers to a presentation of financial data, including accompanying notes, derived from accounting records of the credit union, and intended to disclose a credit union's economic resources or obligations at a appoint in time, or the changes therein for a period of time, in conformity with GAAP or RAP, as defined herein. Each of the following is considered to be a financial statement: a balance sheet or statement of financial condition; statement of income or statement of operations; statement of undivided earnings; statement of cash flows; statement of changes in members' equity; statement of assets and liabilities that does not include members' equity accounts; statement of revenue and expenses; and statement of cash receipts and disbursements.

(4) *GAAP* is an acronym for "generally accepted accounting principles" which refers to the conventions, rules, and procedures which define accepted accounting practice. GAAP includes both broad general guidelines and detailed practices and procedures, provides a standard by which to measure financial statement presentations, and encompasses not only accounting principles and practices but also the methods of applying them.

(5) *GAAS* is an acronym for "generally accepted auditing standards" which refers to the standards approved and adopted by the American Institute of Certified Public Accountants which apply when an "independent, licensed certified public accountant" audits financial statements. Auditing standards differ from auditing procedures in that "procedures" address acts to be performed, whereas "stand-

ards'' measure the quality of the performance of those acts and the objectives to be achieved by use of the procedures undertaken. In addition, auditing standards address the auditor's professional qualifications as well as the judgment exercised in performing the audit and in preparing the report of the audit. Copies of GAAS may be obtained from the AICPA, Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311–3881, telephone (800) TO–AICPA or (800) 862–4272.

(6) *Independence* and *Independent* means the impartiality necessary for the reliability of the compensated auditor's findings. Independence requires the exercise of fairness toward credit union officials, members, creditors and others who may rely upon the supervisory committee audit report.

(7) *Internal controls* refers to the process, established by the credit union's board of directors, officers and employees, designed to provide reasonable assurance of reliable financial reporting and safeguarding of assets against unauthorized acquisition, use, or disposition. A credit union's internal control structure consists of five components: control environment; risk assessment; control activities; information and communication; and monitoring. Reliable financial reporting refers to preparation of financial statements that ''present fairly'' the financial position of the credit union and results of its operations and its cash flows, in conformity with GAAP or RAP, as defined herein. Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition refers to prevention or timely detection of transactions involving such unauthorized access, use, or disposition of assets which could result in a loss that is material to the financial statements.

(8) *Licensed, certified public accountant* refers to an accounting/auditing professional who has received a certificate and license from a duly-appointed state licensing authority to practice accounting/auditing, and is independent as defined herein.

(9) *Opinion audit* refers to an examination of the financial statements performed by an independent, licensed, certified public accountant in accordance with GAAS. The objective of an ''opinion audit'' is to express an opinion as to whether those financial statements of the credit union present fairly, in all material respects, the financial position and the results of its operations and its cash flows in conformity with GAAP or RAP, as defined herein.

(10) *RAP* is an acronym for ''regulatory accounting practices'' which refer to the conventions, rules, and procedures governing accepted accounting practices, other than GAAP, for credit unions and having the substantial support of either the NCUA or the applicable state credit union supervisor.

(11) *Related party transactions* refers to transactions among or between parties where one party controls or can significantly influence the management or operating policies of the other so as to prevent the other party from pursuing exclusively its own interests. Examples of related parties include: executive management, board members, supervisory committee members, credit committee members, and employees, and their families. Examples of ''related party transactions'' include: interest-free loans or loans at below market rates; sale of real estate significantly below appraised value; nonmonetary exchange of property; below market fees, and making of loans lacking scheduled terms for repayment.

(12) *Reportable conditions* refers to a matter coming to the attention of the independent, compensated auditor which, in his or her judgment, represents a significant deficiency in the design or operation of the internal control structure of the credit union, which could adversely affect its ability to record, process, summarize, and report financial data consistent with the representations of management in the financial statements.

(13) *Specified elements, accounts or items of a financial statement* refers to accounting information that is a part of, but significantly less than, a financial statement. These may be directly identified in a financial statement or notes thereto; or they may be derived from a financial statement by analysis, aggregation, summarization, or mathematical computation.

(14) *Substantive testing* refers to testing of details and analytical procedures to detect material misstatements in the account balance, transaction class, and disclosure components of financial statements.

(15) *Supervisory committee* refers to a supervisory committee as defined in Section 111(b) of the Federal Credit Union Act, 12 U.S.C. 1786(r). For some federally-insured state chartered credit unions, the ''audit committee'' designated by state statute or regulation is the equivalent of a supervisory committee.

(16) *Supervisory committee audit* refers to an examination of specified elements, accounts

or items of the credit union's financial statement to the full extent required in this part. An opinion audit as defined herein exceeds the requirements of a "supervisory committee audit."

(17) *Working papers* refers to the principal record, in any form, of the work performed by the auditor and/or supervisory committee to support its findings and/or conclusions concerning significant matters. Examples include the written record of procedures applied, tests performed, information obtained, and pertinent conclusions reached in the engagement, proprietary audit programs, analyses, memoranda, letters of confirmation and representation, abstracts of credit union documents, reviewer's notes, if retained, and schedules or commentaries prepared or obtained by the independent, compensated auditor.

(b) *Supervisory committee responsibilities.* (1) The supervisory committee is responsible for ensuring that:

(i) The financial condition of the credit union is accurately and fairly presented in the credit union's financial statements; and

(ii) The credit union's management practices and procedures are sufficient to safeguard members' assets.

(2) To meet its responsibilities, the supervisory committee shall determine whether:

(i) Internal controls are established and effectively maintained to achieve the credit union's financial reporting objectives which must be sufficient to satisfy the requirements of the supervisory committee audit, verification of members' accounts and its additional responsibilities;

(ii) The credit union's accounting records and financial reports are promptly prepared and accurately reflect operations and results;

(iii) The relevant plans, policies, and control procedures established by the board of directors are properly administered; and

(iv) Policies and control procedures are sufficient to safeguard against error, carelessness, conflict of interest, self-dealing and fraud.

(c) *Supervisory committee audit.* (1) A supervisory committee audit of each Federal credit union shall occur at least once every calendar year and shall cover the period elapsed since the last audit period. The supervisory committee audit shall be performed by the supervisory committee or its designated representative, as prescribed in paragraph (c)(5) of this section.

(2) Standards for Performing Supervisory Committee Audit. The supervisory committee audit procedures/testing must be performed in accordance with the following standards:

(i) The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor commensurate with the level of sophistication and complexity of the credit union under audit.

(ii) Reasonable care is to be exercised in the performance of the audit and the preparation of the report.

(iii) The work is to be adequately planned and assistants, if any, are to be properly supervised.

(iv) The person or persons performing the audit must attain a sufficient understanding of the internal control structure to plan the audit and to determine the nature, timing, and extent of tests to be performed.

(v) The person or persons performing the audit must, through inspection, observation, inquiry, and confirmation obtain sufficient evidence to afford a reasonable basis for the financial statement elements, accounts or items under audit.

(3) Scope of Supervisory Committee Audit. The scope of the supervisory committee audit shall consist of:

(i) Attaining an understanding of the internal control structure;

(ii) Assessing the level of control risk; and

(iii) Based on the level of control risk, determining the nature, timing, and extent of substantive testing necessary to confirm the assertions made by management regarding each of assets, liabilities, equity, income, and expenses for the following attributes:

(A) Existence or occurrence;

(B) Completeness;

(C) Valuation or allocation;

(D) Rights and obligations; and

(E) Presentation and disclosures.

(4) In addition to scope requirements set forth in paragraph (c)(3) of this section, an audit performed by an independent, compensated auditor which includes any of the following areas must, with respect to audit scope but not with respect to reporting, satisfy GAAS for expressing an opinion on the financial statements taken as a whole:

(i) Internal controls;

(ii) Cash;

(iii) Loans and interest thereon;

(iv) Investments and interest thereon;

(v) Shares and dividends and/or interest thereon;

(vi) Related party transactions; and

(vii) The reporting of identified errors and irregularities with regard to each of the items in paragraphs (c)(4) (i) through (vi) of this section.

(5)(i) The requirements of the annual supervisory committee audit may be satisfied by one of the following:

(A) An opinion audit of the credit union's financial statements performed by an independent, licensed, certified public accountant;

(B) An "agreed-upon procedures engagement" performed by an independent, licensed, certified public accountant, which by itself or in combination with procedures performed by the supervisory committee, fulfills the required scope of the supervisory committee audit;

(C) A supervisory committee audit performed by an independent, compensated auditor other than an independent, licensed, certified public accountant which by itself or in combination with procedures performed by the supervisory committee, fulfills the scope of a supervisory committee audit; or

(D) A supervisory committee audit by the supervisory committee or its designated, uncompensated representative.

(ii) In all cases, an independent, compensated auditor is required to contract directly with the supervisory committee for the audit engagement and to deliver its written reports directly to the supervisory committee.

(iii) For a supervisory committee audit performed by the supervisory committee or its designated, uncompensated representative, the supervisory committee shall prepare a written report of the supervisory committee audit.

(d) *Engagement letter.* (1) The engagement of an independent, compensated auditor to perform all or a portion of the scope of a supervisory committee audit shall be evidenced by an engagement letter. The engagement letter shall be signed by the compensated auditor and acknowledged therein by the supervisory committee prior to commencement of a supervisory committee audit. The engagement letter shall:

(i) Specify the terms, conditions, and objectives of engagement;

(ii) Identify the basis of accounting to be used, e.g., GAAP or RAP;

(iii) Include an appendix setting forth the procedures to be performed (if not an opinion audit);

(iv) Specify the rate of, or total, compensation to be paid for the audit;

(v) Provided that the audit shall, upon completion of the engagement, deliver to the supervisory committee:

(A) A written report of the supervisory committee audit; and

(B) Notice in writing, either within the report or communicated separately, of any internal control reportable conditions and/or irregularities or illegal acts which come to the auditor's attention during the normal course of the audit (i.e., no additional duty is imposed nor additional written communications beyond (A) is required if none of these is noted);

(vi) Specify a target date of delivery of the written reports;

(vii) Certify that NCUA staff or its designated representative will be provided unconditional access to the complete set of original working papers either at the credit union or at a mutually agreeable location, for purposes of inspection; and

(viii) Acknowledge that working papers shall be retained for a minimum of three years from the date of the written audit report.

(2) In the case of a supervisory committee audit engagement which addresses all of the financial statement elements, accounts or items and attributes prescribed in paragraphs (c)(3) and (c)(4) of this section, the engagement letter shall certify that the contracted scope of the audit satisfies the requirements of a complete supervisory committee audit.

(3) In the case of a supervisory committee audit engagement which excludes any financial statement elements, accounts or items and attributes prescribed in paragraphs (c)(3) and (c)(4) of this section, the engagement letter shall:

(i) Identify the elements, accounts or items and attributes excluded from the audit;

(ii) State that, because of the exclusion(s), the resulting audit will not, by itself, fulfill the scope of a supervisory committee audit; and

(iii) Caution that the supervisory committee will remain responsible for fulfilling the scope of a supervisory committee audit with respect to the excluded elements, accounts or items and attributes.

(e) *Audit reports and working paper access.* (1) Upon completion or receipt of the written super-

visory committee audit reports, the supervisory committee shall provide the reports to the board of directors. The supervisory committee shall ensure that the independent, compensated audit and its reports comply with the terms of the engagement letter prescribed in this section. The supervisory committee shall, upon request, provide to the National Credit Union Administration a copy of the written reports received from the auditor.

(2) The supervisory committee shall be responsible for preparing and maintaining, or making available, a complete set of original working papers supporting each supervisory committee audit. The supervisory committee shall, upon request, provide NCUA staff unconditional access to such working papers either at the offices of the credit union or at a mutually agreeable location, for purposes of inspecting such working papers.

(f) *Sanctions.* (1) Failure of a supervisory committee and/or its independent compensated auditor to comply with the requirements of this section, or the terms of an engagement letter required by this section, is grounds for:

(i) The regional director to reject the supervisory committee audit;

(ii) The regional director to impose the remedies available in § 701.13, provided any of the conditions specified in § 701.13 is present; and

(iii) The NCUA to seek formal administrative sanctions against the supervisory committee and/or its independent, compensated auditor pursuant to section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).

(2) In the case of a federally-insured state chartered credit union, NCUA shall provide the state regulator an opportunity to timely impose a remedy satisfactory to NCUA before seeking to impose a sanction permitted under (f)(1) of this section.

(g) Federal credit union compensated auditors, performing audits for supervisory committees, must be independent of the credit union's employees, members of the board of directors, supervisory and credit committees and/or the credit union's loan officers, and members of their immediate families. "Members of their immediate families" means a spouse, or a child, parent, grandchild, grandparent, brother or sister, or the spouse of any such individual.

(h)(1) The verification of members' accounts shall be made using any of the following methods:

(i) A controlled verification of 100 percent of members' share and loan accounts;

(ii) A sampling method that provides a random selection that is expected to be representative of the population from which the sample was selected, which will allow the auditor to test sufficient accounts in both number and scope to provide assurance that the General Ledger accounts are fairly stated in relation to the financial statements taken as a whole. When the auditor concludes that evidence provided by confirmations alone is not sufficient, additional procedures should be performed. That sampling procedure must provide each dollar in the population an equal chance of being selected;

(iii) *Independent, licensed, certified public accountants* are provided the additional option or sampling members' accounts using nonstatistical sampling methods consistent with *applicable* generally accepted auditing standards, provided the sampling method provides a selection that allows the auditor to test sufficient accounts in both number and scope to provide assurance that the General Ledger accounts are fairly stated in relation to the financial statements taken as a whole. When the auditor concludes that evidence provided by confirmations alone is not sufficient, additional procedures should be performed. Independent, licensed, certified public accountants will be responsible for documenting their sampling procedures, and providing evidence to NCUA, if requested, that the method used in consistent with *applicable* generally accepted auditing standards.

(2) Records of those accounts verified will be maintained and will be retained until the next verification of members' accounts is completed.

§ 701.13 Requirements for an Outside Audit.

(a) A Federal credit union shall obtain an outside, independent audit by a certified public accountant for any fiscal year during which any one of the following three conditions is present:

(1) the supervisory committee on the Federal credit union has not conducted an annual supervisory committee audit;

(2) the annual supervisory committee audit conducted did not meet the audit requirements of § 701.12 including § 701.12(h);

(3) the Federal credit union has experienced serious and persistent recordkeeping deficiencies as defined in Subsection (c) below.

(b) In the case of an audit required pursuant to condition (1) or (2) in paragraph (a) above, the scope of the outside, independent audit conducted by a certified public accountant must fully encompass the requirements set forth in § 701.12. In the case of an audit required pursuant to condition (3) above, the outside, independent audit by a certified public accountant must be an opinion audit as that term is understood under generally accepted auditing standards.

(c) As used in condition (3) of paragraph (a) above, persistent recordkeeping deficiencies shall mean serious recordkeeping problems which continue to exist past a usual, expected, or normal period of time. Persistent recordkeeping deficiencies shall be considered serious if the Administration has a reasonable doubt that the financial condition of the credit union is accurately and fairly presented in the credit union's statements and that management practices and procedures are sufficient to safeguard members' assets.

§ 701.14 Change in Official or Senior Executive Officer in Credit Unions that are Newly Chartered or are in Troubled Condition.

(a) *Statement of Scope and Purpose.* Section 212 of the Federal Credit Union Act (12 U.S.C. 1790a) sets forth conditions under which a credit union must notify NCUA in writing of any proposed changes in its board of directors, committee members or senior executive staff. The regulation only applies in cases of newly chartered credit unions and credit unions in troubled condition.

(b) *Definitions.* For the purposes of this section:

(1) "Committee member" means any individual who serves as an official of the credit union in the capacity of a credit committee member or supervisory committee member.

(2) "Senior executive officer" means a credit union's chief executive officer (typically this individual holds the title of president or treasurer/manager), any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager) and the chief financial officer (controller). The term "senior executive officer" also includes employees of an entity, such as a consulting firm, hired to perform the functions of positions covered by the regulation.

(3) "Troubled condition" means any insured credit union that has one or a combination of the following conditions:

(i) Has been assigned

(A) A 4 or 5 CAMEL composite rating by the NCUA in the case of a federal credit union, or

(B) An equivalent 4 or 5 CAMEL composite rating by the state supervisor in the case of a federally insured, state-chartered credit union, or

(C) A 4 or 5 CAMEL composite rating by NCUA based on core workpapers received from the state supervisor in the case of a federally insured, state-chartered credit union in a state that does not use the CAMEL system. In this case, the state supervisor will be notified in writing by the Regional Director in the Region in which the credit union is located that the credit union has been designated by NCUA as a troubled institution;

(ii) Has been granted assistance as outlined under Sections 116 or 208 of the Federal Credit Union Act.

(c) *Prior Notice Requirement.* An insured credit union shall give NCUA written notice at least 30 days prior to the effective date of any addition or replacement of a member of the board of directors or committee member or the employment or change in responsibilities of any individual to a position as a senior executive officer if:

(1) The credit union has been chartered for less than 2 years; or

(2) The credit union meets the definition of troubled condition as set forth in paragraph 701.14(b)(3).

(d) *Procedures for Notice of Proposed Change in Official or Senior Executive Officer.*

(1) *Filing and acceptance.* Notices shall be filed with the appropriate Regional Director. State-chartered federally insured credit unions shall also file a copy of the notice with their state supervisor. The notice shall contain information pertaining to the competence, experience, character, or integrity of the individual with respect to whom the notice is submitted, subject to the authority of the Regional Director or his or her designee to require additional information. The information submitted must include the identity, personal history, business background, and experience of the individual, including material business activities and affiliations during the past 5 years, and a description of any material pending legal or administrative proceedings in which the individ-

ual is a party and any criminal indictment or conviction of such person by a state or Federal court. Each individual on whose behalf the notice is filed must attest to the validity of the information filed. At the option of the individual, the information may be forwarded to the Regional Director by the individual; however, in such cases, the credit union must file a notice to that effect. The credit union submitting the notice shall be notified in writing of the date on which all required information is received and the notice is accepted for processing. Before the end of the 30-day period beginning on the date NCUA accepts the information for processing, the Regional Director will issue a written notice to the individual and the credit union of disapproval or approval of the proposed official or employee. If, after the 30-day period has ended, the individual has not been informed in writing of NCUA's disposition, the individual shall be considered approved.

(2) *Waiver of prior notice requirement.* Parties may petition the appropriate Regional Director for a waiver of the prior notice required under this Section. Waiver may be granted if it is found that delay could harm the credit union or the public interest. Any waiver shall not affect the authority of NCUA to issue a Notice of Disapproval within 30 days of the waiver, or within 30 days of any subsequent required notice.

(3) *Election of directors or credit committee members.*

(i) In the case of the election of a new member of the board of directors or credit committee member at a meeting of the members of a federally insured credit union, prior notice is not required. However, a completed notice must be filed with the appropriate Regional Director within 48 hours of the election.

(ii) If a director or credit committee member is disapproved by NCUA, the board of directors of the credit union may appoint its own alternate, to serve until the next annual meeting, contingent upon NCUA approval.

(e) *Commencement of service.* A proposed director, committee member or senior executive officer may begin to serve temporarily until the credit union and the individual are notified in writing of NCUA's approval or disapproval of the proposed addition or employment.

(f) *Notice of Disapproval.* NCUA may disapprove the individual's serving as a director, committee member or senior executive officer if it finds that the competence, experience, character, or integrity of the individual with respect to whom a notice under this section is submitted indicates that it would not be in the best interests of the members of the credit union or of the public to permit the individual to be employed by, or associated with, the credit union. The Notice of Disapproval will advise the parties of their rights of appeal pursuant to 12 CFR Part 747 subpart J of NCUA's Regulations.

§§ 701.15–701.18 [Reserved]

§ 701.19 Retirement Benefits for Employees of Federal Credit Unions.

(a) A Federal credit union may make provision for reasonable retirement benefits for its employees and for officers who are compensated in conformance with the Act and the bylaws, either individually or collectively with other credit unions. In those cases where a Federal credit union is to be a plan trustee or custodian, the plan must be an individual retirement account maintained in accordance with the provisions of Part 724. Where the trustee or custodian is a party other than the Federal credit union, the employee benefit plan must be maintained in accordance with the applicable laws governing employee benefit plans and such rules and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other Federal or state authority exercising jurisdiction over such plans.

(b) No Federal credit union shall occupy the position of a fiduciary, as defined in the Employee Retirement Income Security Act of 1974 and rules and regulations promulgated thereunder by the Secretary of Labor, unless provision has been made for appropriate liability insurance as provided under Section 410(b) of the Employee Retirement Income Security Act of 1974.

§ 701.20 Fidelity Bond and Insurance Coverage for Federal Credit Unions.

(a) *Scope.* This Part provides the requirements for fidelity bonds for Federal credit union employees and officials and for general insurance coverage for losses caused by persons outside of the credit union (protection for losses due to theft, holdup, vandalism, etc.).

(b) *Review of Coverage.* The board of directors of each Federal credit union shall, at least annually, carefully review the bond and insurance coverage in force in order to ascertain its adequacy in relation to risk exposure and to the minimum requirements fixed from time to time by the NCUA Board.

(c) *Minimum Coverage; Approved Forms.* Every Federal credit union will maintain bond and insurance coverage with a company holding a certificate of authority from the Secretary of the Treasury. Credit Union Blanket Bond Standard Form No. 23 of the Surety Association of America (revised to May, 1950) is considered the minimum coverage required and is approved. Credit Union Blanket Bond Forms 581 and 582 are also approved. Any other basic bond forms, and all riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of the NCUA Board. Fidelity bonds must provide coverage for the fraud or dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, effective January 1, 1990 all bonds must include a provision, in a form approved by the NCUA Board, requiring written notification by surety to the Board: (1) when the bond of a credit union is terminated in its entirety; or (2) when bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member. Said notification shall be sent to the Secretary of the NCUA Board or designee and shall include a brief statement of cause for termination.

(d) *Minimum Coverage Amounts.* The minimum amount of bond coverage required will be computed based on the Federal credit union's total assets. The following table lists the minimum requirements:

Assets	Minimum Bond
$0 to $10,000	Coverage equal to the credit union's assets.
$10,001 to $1,000,000	$10,000 for each $100,000 or fraction thereof.
$1,000,001 to $50,000,000	$100,000 plus $50,000 for each million or fraction over $1,000,000.
$50,000,001 to $295,000,000	$2,550,000 plus $10,000 for each million or fraction thereof over $50,000,000.
Over $295,000,000	$5,000,000.

It is the duty of the board of directors of each Federal credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond and insurance coverage in excess of the above minimums.

(e) *Increased Coverage, Cash on Hand or in Transit.* When either of the following amounts exceed a Federal credit union's minimum coverage limits as specified in paragraph (d) of this regulation, the minimum coverage limits for that Federal credit union will be increased to be equal to the greater of the following amounts within thirty days of the discovery of the need for such increase:

(1) The aggregate amount of the daily cash fund (change fund plus maximum anticipated daily money receipts) and food stamps (if any), on the Federal credit union's premises, or

(2) The aggregate amount of the Federal credit union's money and food stamps (if any) placed in transit in any one individual shipment.

For purposes of this Section, the term "money" shall include currency, coin, banknotes, Federal Reserve notes, revenue stamps and postage stamps.

(f) *Increased Cash Coverage; Exception.* Subsection (e) notwithstanding, no increase in coverage will be required where a Federal credit union temporarily increases its cash fund because of an extraordinary event which reasonably cannot be expected to recur.

(g) *Reduced Coverage; NCUA Approval.* Any proposal for reduced coverage must be approved in writing by the NCUA Board at least twenty days in advance of the proposed effective date of the reduction.

(h) *Deductibles.*

(1) The maximum amount of deductibles allowed are based on the Federal credit union's total assets. The following table sets out the maximum deductibles:

Assets	Minimum Bond
$0–$100,000	No deductibles allowed
$100,001–$250,000	$1,000.
$250,001–$1,000,000	$2,000.
Over $1,000,001	$2,000 plus 1/1000 of total assets up to a maximum deductible of $200,000.

(2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those shown in this Section must have the written approval of the NCUA Board at least twenty days prior to the effective date of such deductibles.

(3) No deductible will exceed ten percent of a Federal credit union's Regular Reserve unless the credit union creates a segregated Contingency Reserve for the amount of the excess. Valuation allowance accounts, e.g., allowance for loan losses, may not be considered part of the Regular Reserve when determining the maximum deductible.

(i) *Additional Coverage.* The NCUA Board may require additional coverage for any Federal credit union when, in the opinion of the Board, current coverage is insufficient. The board of directors of the Federal credit union must obtain additional coverage within thirty days after the date of written notice from the NCUA Board.

§ 701.21 Loans to Members and Lines of Credit to Members.

(a) *Statement of Scope and Purpose.* Section 701.21 complements the provisions of Section 107(5) of the Federal Credit Union Act (12 U.S.C. § 1757(5)) authorizing Federal credit unions to make loans to members and issue lines of credit (including credit cards) to members. Section 107(5) of the Act contains limitations on matters such as loan maturity, rate of interest, security, and prepayment penalties. Section 701.21 interprets and implements those provisions. In addition, Section 701.21 states the NCUA Board's intent concerning preemption of state laws, and expands the authority of Federal credit unions to enforce due-on-sale clauses in real property loans. Also, while § 701.21 generally applies to Federal credit unions only, its provisions may be used by state-chartered credit unions with respect to alternative mortgage transactions in accordance with 12 U.S.C. 3801 *et seq.*, and certain provisions apply to loans made by federally insured state-chartered credit unions as specified in § 741.203 of this chapter. Part 722 sets forth requirements for appraisals for certain real estate-secured loans made under Section 701.21 and any other applicable lending authority. Finally, it is noted that Section 701.21 does not apply to loans by Federal credit unions to other credit unions (although certain statutory limitations in Section 107 of the Act apply), nor to loans to credit union organizations (which are governed by Section 107(5)(D) of the Act and Section 701.27 of this Part.

(b) *Relation to Other Laws:*

(1) *Preemption of state laws.* Section 701.21 is promulgated pursuant to the NCUA Board's exclusive authority as set forth in Section 107(5) of the Federal Credit Union Act (12 U.S.C. § 1757(5)) to regulate the rates, terms of repayment and other conditions of Federal credit union loans and lines of credit (including credit cards) to members. This exercise of the Board's authority preempts any state law purporting to limit or affect:

(i) (A) rates of interest and amounts of finance charges, including:

(1) the frequency or the increments by which a variable interest rate may be changed;

(2) the index to which a variable interest rate may be tied;

(3) the manner or timing of notifying the borrower of a change in interest rate;

(4) the authority to increase the interest rate on an existing balance;

(B) late charges; and

(C) closing costs, application, origination, or other fees;

(ii) terms of repayment, including:

(A) the maturity of loans and lines of credit;

(B) the amount, uniformity, and frequency of payments, including the accrual of unpaid interest if payments are insufficient to pay all interest due;

(C) balloon payments; and

(D) prepayment limits;

(iii) conditions related to:

(A) the amount of the loan or line of credit;

(B) the purpose of the loan or line of credit;

(C) the type or amount of security and the relation of the value of the security to the amount of the loan or line of credit;

(D) eligible borrowers; and

(E) the imposition and enforcement of liens on the shares of borrowers and accommodation parties.

(2) *Matters not preempted.* Except as provided by Section 701.21(b)(1), it is not the Board's intent to preempt state laws that do not affect rates, terms of repayment and other conditions described above concerning loans and lines of credit, for example:

(i) insurance laws;

(ii) laws related to transfer of and security interests in real and personal property (see, however, paragraph (g)(6) of this section concerning the use and exercise of due-on-sale clauses);

(iii) conditions related to:

(A) collection costs and attorneys' fees;

(B) requirements that consumer lending documents be in "plain language"; and

(C) the circumstances in which a borrower may be declared in default and may cure default.

(3) *Other Federal law.* Except as provided by Section 701.21(b)(1), it is not the Board's intent to preempt state laws affecting aspects of credit transactions that are primarily regulated by Federal law other than the Federal Credit Union Act, for example, state laws concerning credit cost disclosure requirements, credit discrimination, credit reporting practices, unfair credit practices, and debt collection practices. Applicability of state law in these instances should be determined pursuant to the preemption standards of the relevant Federal law and regulations.

(4) *Examination and Enforcement.* Except as otherwise agreed by the NCUA Board, the Board retains exclusive examination and administrative enforcement jurisdiction over Federal credit unions. Violations of Federal or applicable state laws related to the lending activities of a Federal credit union should be referred to the appropriate NCUA regional office.

(5) *Definition of State Law.* For purposes of Section 701.21(b) "state law" means the constitution, laws, regulations and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

(c) *General Rules:*

(1) *Scope.* The following general rules apply to all loans to members and, where indicated, all lines of credit (including credit cards) to members, except as otherwise provided in the remaining provisions of Section 701.21.

(2) *Written policies.* The board of directors of each Federal credit union shall establish written policies for loans and lines of credit consistent with the relevant provisions of the Act, NCUA's regulations, and other applicable laws and regulations.

(3) *Credit application.* Consistent with policies established by the board of directors, the credit committee or loan officer shall ensure that a credit application is kept on file for each borrower supporting the decision to make a loan or establish a line of credit.

(4) *Maturity.* The maturity of a loan to a member may not exceed 12 years. Lines of credit are not subject to a statutory or regulatory maturity limit. Amortization of line of credit balances and the type and amount of security on any line of credit shall be as determined by contract between the Federal credit union and the member/borrower.

(5) *Ten percent limit.* No loan or line of credit advance may be made to any member if such loan or advance would cause that member to be indebted to the Federal credit union upon loans and advances made to the member in an aggregated amount exceeding 10% of the credit union's total unimpaired shares and surplus. In the case of member business loans as defined in Section 701.21(h)(1)(i), additional limitations apply as set forth in Section 701.21(h)(2)(ii).

(6) *Early payment.* A member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty.

(7) *Loan interest rates.*

(i) *General.* Except when a higher maximum rate is provided for in 701.21(c)(7)(ii), a Federal credit union may extend credit to its members at rates not to exceed 15 percent per year on the unpaid balance inclusive of all finance charges. Variable rates are permitted on the condition that the effective rate over the term of the loan (or line of credit) does not exceed the maximum permissible rate.

(ii) *Temporary rates.—(A) 21 percent maximum rate.* Effective from December 3, 1980 through May 14, 1987, a Federal credit union may extend credit to its members at rates not to exceed 21 percent per year on the unpaid balance inclusive of all finance charges. Loans and line of credit balances existing on or before May 14, 1987, may continue to bear rates of interest of up to 21 percent per year after May 14, 1987.

(B) *18 percent maximum rate.* Effective May 15, 1987, a Federal credit union may extend credit to its members at rates not to exceed 18 percent per year on the unpaid balance inclusive of all finance charges.

(C) *Expiration.* After September 8, 1997, or as otherwise ordered by the NCUA Board, the maximum rate on federal credit union extensions of credit to members shall revert to 15 percent per year. Higher rates may, however, be charged, in accordance with paragraph (c)(7)(ii) (A) and (B) of this section, on loans and line of credit balances existing on or before September 8, 1997.

(8)(i) Except as otherwise provided herein, no official or employee of a Federal credit union, or immediate family member of an official or employee of a Federal credit union, may receive, directly or indirectly, any commission, fee, or other compensation in connection with any loan made by the credit union.

(ii) For the purposes of this section:

Compensation includes non monetary items, except those of nominal value.

Immediate family member means a spouse or other family member living in the same household.

Loan includes line of credit.

Official means any member of the board of directors or a volunteer committee.

Person means an individual or an organization.

Senior management employee means the credit union's chief executive officer (typically, this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager), and the chief financial officer (Comptroller).

Volunteer official means an official of a credit union who does not receive compensation from the credit union solely for his or her service as an official.

(iii) This section does not prohibit:

(A) Payment, by a Federal credit union, of salary to employees;

(B) Payment, by a Federal credit union, of an incentive or bonus to an employee based on the credit union's overall financial performance;

(C) Payment, by a Federal credit union, of an incentive or bonus to an employee, other than a senior management employee, in connection with a loan or loans made by the credit union, provided that the board of directors of the credit union establishes written policies and internal controls in connection with such incentive or bonus and monitors compliance with such policies and controls at least annually.

(D) Receipt of compensation from a person outside a Federal credit union by a volunteer official or non senior management employee of the credit union, or an immediate family member of a volunteer official or employee of the credit union, for a service or activity performed outside the credit union, provided that no referral has been made by the credit union or the official, employee, or family member.

(d) *Loans and Lines of Credit to Officials:*

(1) *Purpose.* Sections 107(5)(A) (iv) and (v) of the Act require the approval of the board of directors of the Federal credit union in any case where the aggregate of loans to an official and loans on which that official serves as endorser or guarantor exceeds $20,000 plus pledged shares. This Section (701.21(d)) implements the requirement by establishing procedures for determining whether board of directors' approval is required. The section also prohibits preferential treatment of officials.

(2) *Official.* An "official" is any member of the board of directors, credit committee or supervisory committee.

(3) *Initial approval.* All applications for loan or lines of credit on which an official will be either a direct obligor or an endorser, cosigner or guarantor shall be initially acted upon by either the board of directors, the credit committee or loan officer, as specified in the Federal credit union's bylaws.

(4) *Board of directors' review.* The board of directors shall, in any case, review and approve or deny an application on which an official is a direct obligor, or endorser, cosigner or guarantor if the following computation produces a total in excess of $20,000:

(i) Add:

(A) The amount of the current application.

(B) The outstanding balances of loans including the used portion of an approved line of credit, extended to or endorsed, cosigned or guaranteed by the official.

(C) The total unused portion of approved lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(ii) From the above total subtract:

(A) the amount of shares pledged by the official on loans or lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(B) The amount of shares to be pledged by the official on the loan or line of credit applied for.

(5) *Nonpreferential treatment.* The rates, terms and conditions on any loan or line of credit either made to, or endorsed or guaranteed by

(i) an official

(ii) an immediate family member of an official, or

(iii) any individual having a common ownership, investment or other pecuniary interest in a business enterprise with an official or with an immediate family member of an official shall not be more favorable than the rates, terms and conditions for comparable loans or lines of credit to other credit union members. "Immediate family members" means a spouse or other family member living in the same household.

(e) *Insured, Guaranteed and Advance Commitment Loans.* A loan secured by the insurance or

guarantee of, or with an advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either, may be made for the maturity and under the terms and conditions, including rate of interest, specified in the law, regulations or program under which the insurance, guarantee or commitment is provided.

(f) *20-Year Loans.* Notwithstanding the general 12-year maturity limit on loans to members, a Federal credit union may make loans with maturities of up to 20 years in the case of: (1) a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence and the loan is secured by a first lien on the mobile home, (2) a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower, and (3) a loan to finance the repair, alteration, or improvement of a residential dwelling which is the residence of the member-borrower.

(g) *Long-Term Mortgage Loans:*

(1) *Authority.* A Federal credit union may make residential real estate loans to members, with maturities of up to 40 years, or such longer period as may be permitted by the NCUA Board on a case-by-case basis, subject to the conditions of this Section (701.21(g)).

(2) *Statutory limits.* The loan shall be made on a one- to four-family dwelling that is or will be the principal residence of the member-borrower and the loan shall be secured by a perfected first lien in favor of the credit union on such dwelling (or a perfected first security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

(3) *Loan application.* The loan application shall be a completed standard Federal Housing Administration, Veterans Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association application form. In lieu of use of a standard application the Federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable Federal, state and local laws.

(4) *Security instrument and note.* The security instrument and note shall be executed on the most current version of the FHA, VA, FHLMC, FNMA, or FHLMC/FNMA Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that would be applicable to principal. In lieu of use of a standard security instrument and note, the Federal credit union may have a current attorney's opinion on file stating that the security instrument and note in use meet the requirements of applicable Federal, state and local laws.

(5) *First lien, territorial limits.* The loan shall be secured by a perfected first lien or first security interest in favor of the credit union supported by a properly executed and recorded security instrument. No loan shall be secured by a residence located outside the United States of America, its territories and possessions, or the Commonwealth of Puerto Rico.

(6) *Due-on-sale clauses:*

(i) Except as otherwise provided herein, the exercise of a due-on-sale clause by a Federal credit union is governed exclusively by Section 341 of Public Law 97–320 and by any regulations issued by the Federal Home Loan Bank Board implementing Section 341.

(ii) In the case of a contract involving a long-term (greater than twelve years), fixed rate first mortgage loan which was made or assumed, including a transfer of the liened property subject to the loan, during the period beginning on the date a state adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such state has rendered a decision (or if the highest court has not so decided, the date on which the next highest court has rendered a decision resulting in a final judgment if such decision applies statewide) prohibiting such exercise, and ending on October 15, 1982, a Federal credit union may exercise a due-on-sale clause in the case of a transfer which occurs on or after November 18, 1982, unless exercise of the due-on-sale clause would be based on any of the following:

(A) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;

(B) the creation of a purchase money security interest for household appliances;

(C) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(D) the granting of a leasehold interest of 3 years or less not containing an option to purchase;

(E) a transfer to a relative resulting from the death of a borrower;

(F) a transfer where the spouse or children of the borrower become an owner of the property;

(G) a transfer resulting from a decree of a dissolution of marriage, a legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(H) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

(I) any other transfer or disposition described in regulations promulgated by the Federal Home Loan Bank Board.

(h) *Member Business Loans*

(1) *Definitions.*

(i) "Member business loans" mean any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate, business investment property or venture, or agricultural purpose, except that the following shall not be considered member business loans for the purposes of this Section:

(A) A loan or loans fully secured by a lien on a 1- to 4-family dwelling that is the member's primary residence.

(B) A loan that is fully secured by shares in the credit union or deposits in other financial institutions.

(C) A loan meeting the general definition of member business loans under this paragraph (h)(1)(i), and, made to a borrower or an associated member (as defined in paragraph (h)(1)(iii)) of this section), which when added to other such loans to the borrower or associated member, is less than $50,000.

(D) A loan, the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by any agency of the Federal government or of a state or any of its political subdivisions.

(E) A loan granted by a corporate credit union operating under the provisions of Part 704 of these rules, to another credit union.

(ii) "Reserves" mean all reserves, including the Allowance for Loan Losses and undivided earnings or surplus.

(iii) "Associated Member" means any member with a shared ownership, investment or other pecuniary interest in a business or commercial endeavor with the borrower.

(iv) "Immediate Family Member" means a spouse or other family member living in the same household.

(v) "Loan-to-value" (LTV) ratio means the quotient of the aggregate amount of all sums borrowed from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

(vi) "Construction or development loan" means a financing arrangement for the purpose of acquisition of property or rights to property, including land or structures, with the intent of conversion into income-producing property including residential housing for rental or sale, commercial, or industrial use, or a similar use.

(2) *Requirements.* Member business loans, as defined in Section 701.21(h)(1)(i), may be made by Federal credit unions only in accordance with the applicable provisions of Section 701.21 (a) through (g) above, to the extent that they are not inconsistent with this Section, and the following additional requirements:

(i) *Written Loan Policies.* The board of directors must adopt specific business loan policies and review them at least annually. The policies shall, at a minimum, address the following:

(A) Types of business loans that will be made;

(B) The credit union's trade area for business loans;

(C) Maximum amount of credit union assets, in relation to reserves, that will be invested in business loans;

(D) Maximum amount of credit union assets, in relation to reserves, that will be invested in a given category or type of business loan;

(E) Maximum amount of credit union assets, in relation to reserves, that will be loaned to any one member or group of associated members, subject to Section 701.21(h)(2)(iii)(A) below;

(F) Qualifications and experience of personnel involved in making and administering business loans with a minimum of 2 years direct experience with this type of lending;

(G) Analysis of the ability of the borrower to repay the loan;

(H) Documentation supporting each request for an extension of credit or an increase in an existing loan or line of credit shall (except where the board of directors finds that such documentation requirements are not generally available for a particular type of business loan and states the reasons for those findings in the credit union's written policies) include the following: balance sheet, cash flow analysis, income statement, tax data, leveraging, comparison with industry average, receipt and periodic updating of financial statements and other documentation, including tax returns;

(I) Collateral requirements, including loan-to-value ratios; appraisal, title search and insurance requirements; steps to be taken to secure various types of collateral; and how often the value and marketability of collateral is reevaluated;

(J) Appropriate interest rates and maturities of business loans;

(K) Loan monitoring, servicing and follow-up procedures, including collection procedures;

(L) Provision for periodic disclosure to the credit union's members of the number and aggregate dollar amount of member business loans;

(M) Identification, by position, of those senior management employees prohibited by paragraph (h)(3) from receiving member business loans.

(ii) *Other Policies.* The following minimum limits and policies shall also be established in writing and reviewed at least annually for loans granted under this section:

(A) Unless a credit union loan program was in existence prior to January 1, 1992, and is granted an exemption by the regional director, loans shall be granted on a fully secured basis by collateral as follows:

(1) second lien for LTV ratios of up to 70 percent;

(2) first lien for LTV ratios of up to 80 percent;

(3) first lien with an LTV ratio in excess of 80 percent shall be granted only where the value in excess of 80 percent is covered through acquisition of private mortgage, or equivalent type, insurance provided by an insurer acceptable to the credit union or insurance or guarantees by or subject to advance commitment to purchase by an agency of the Federal government or of a state or any of its political subdivisions, and in no event shall the LTV ratio exceed 95 percent;

(B) Loans shall not be granted without the personal liability and guarantees of the principals (natural person members) except where the borrower is a not-for-profit organization as defined by the Internal Revenue Service Code (26 U.S.C. 501);

(C) Federally insured, state-chartered credit unions are exempt from the provisions of Section 701.21(h)(2)(ii)(A) of this Part with respect to credit card line of credit programs offered to nonnatural person members which are limited to routine purposes normally made available under such programs.

(iii) *Loan Limits.*

(A) *Loans to One Borrower.* Unless a greater amount is approved by the NCUA regional director, the aggregate amount of outstanding member business loans to any one member or group of associated members shall not exceed 15% of the credit union's reserves (less the Allowance for Loan Losses account), or $75,000, whichever is higher. If any portion of a member business loan is secured by shares in the credit union, or deposits in another financial institution, or fully or partially insured or guaranteed by, or subject to an advance commitment to purchase by, any agency of the Federal government or of a state or any of its political subdivisions, such portion shall not be calculated in determining the 15% limit.

(B) *Exceptions.* Credit unions seeking an exception from the LTV ratios of Section 701.21(h)(2)(ii)(A), or the limits of Section 701.21(h)(2)(iii)(A) or Section 701.21(h)(3) must present the regional director with, at a minimum: the higher limit sought; an explanation of the need by the members to raise the limit and ability of the credit union to manage this activity; an analysis of the credit union's prior experience making member business loans; and a copy of its business lending policy. The analysis of credit union experience in making member business loans shall document the history of loan losses, loan delinquency, volume and cyclical or seasonal patterns, diversification, concentrations of credit to one borrower or group of associated borrowers in excess of 15 percent of reserves (less the Allowance for Loan Losses account), underwriting standards and practices, types of loans grouped by purpose and collateral, and qualifications of personnel responsible for underwriting and administering member

business loans. Regional directors shall consider, in addition to the information submitted by the credit union, the historical CAMEL ratings. If the credit union does not receive notification of the action taken within 30 calendar days of the date the request was received by the regional office, the credit union may assume approval of the request to exceed the limit. The regional director's decision may be appealed to the NCUA Board.

(C) *Maturity.* Member business loans shall be granted for periods consistent with the purpose, security, creditworthiness of the borrower, and sound lending policies.

(D) *Monitoring Requirement.* Credit unions with member business loans in excess of 100 percent of reserves (less the Allowance for Loan Losses account) shall submit the following information regarding member business loans to their respective regional director on a quarterly basis: the aggregate total of loans outstanding; the amount of loans delinquent in excess of 30 days; the balance of the allowance for member business loan losses; the aggregate total of all concentrations of credit to one borrower or group of associated borrowers in excess of 15 percent of reserves (less the Allowance for Loan Losses account); the total number and amount of all construction, development or speculative loans; and any other information pertinent to the safe and sound condition of the member business loan portfolio.

(iv) *Allowance for Loan Losses.*

(A) The determination whether a member business loan will be classified as substandard, doubtful, or loss, for purposes of the valuation allowance for loan losses, will rely on factors not limited to the delinquency of the loan. Nondelinquent loans may be classified, depending on an evaluation of factors, including, but not limited to, the adequacy of analysis and documentation. The criteria for determining the classification of loans is contained in the Appendix to Section 701.21(h)—Classifications.

(B) Loans classified shall be reserved as follows:

(1) Loss loans at 100% of outstanding amount;

(2) Doubtful loans at 50% of outstanding amounts; and

(3) Substandard loans at 10% of outstanding amount unless other factors (e.g., history of such loans at the credit union) indicate a greater or lesser amount is appropriate.

(3) *Construction and Development Lending.* Unless an exemption is approved by the regional director, loans granted under this Section to finance the construction or development of commercial or residential property shall be subject to the following additional provisions:

(i) The aggregate of all such loans, excluding any portion of a loan secured by shares in the credit union, or deposits in another financial institution, or fully or partially insured or guaranteed by, or subject to an advance commitment to purchase by, any agency of the Federal government or of a state or any of its political subdivisions, shall not exceed 15 percent of reserves (less the Allowance for Loan Losses account);

(ii) The borrower shall have a minimum of 35 percent equity interest in the project being financed;

(iii) Funds for such projects shall be released following on-site inspections by independent, qualified personnel in accordance with a preapproved draw schedule.

(4) *Prohibitions.*

(i) *Senior Management Employees.* A Federal credit union may not make member business loans to the following:

(A) Any member of the board of directors who is compensated as such.

(B) The credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager).

(C) Any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager).

(D) The chief financial officer (Comptroller).

(E) Any associated member or immediate family member of (A)–(D) above.

(ii) *Equity Kickers/Joint Ventures.* A Federal credit union shall not grant a member business loan where a portion of the amount of income to be received by the credit union in conjunction with such loan is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

(5) *Recordkeeping.* All loans, lines of credit, or letters of credit, that meet the definitions of Section 701.21(h)(1)(i), shall be separately identified in the records of the credit union and reported as such in financial and statistical reports required by the National Credit Union Administration.

(6) *Effective Date.* Section 701.21(h) is effective January 1, 1992. All member business

loans granted on or after that date must be in full compliance with Section 701.21(h).

(i) *Put Option Purchases in Managing Increased Interest-Rate Risk for Real Estate Loans Produced for Sale on the Secondary Market.*

(1) *Definitions.* For purposes of this § 701.21(i):

(i) "Financial options contact" means an agreement to make or take delivery of a standardized financial instrument upon demand by the holder of the contract at any time prior to the expiration date specified in the agreement, under terms and conditions established either by (A) a contract market designated for trading such contracts by the Commodity Futures Trading Commission, or (B) by a Federal credit union and a primary dealer in Government securities that are counterparties in an over-the-counter transaction.

(ii) "FHLMC security" means obligations or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Sections 305 or 306 of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. §§ 1454 and 1455).

(iii) "FNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association.

(iv) "GNMA security" means an obligation, participation, or any instrument of or issued by, or fully guaranteed as to principal and interest by, the Government National Mortgage Association.

(v) "Long position" means the holding of a financial options contract with the option to make or take delivery of a financial instrument.

(vi) "Primary dealer in Government securities" means: (A) a member of the Association of Primary Dealers in United States Government Securities; or (B) any parent, subsidiary, or affiliated entity of such primary dealer where the member guarantees (to the satisfaction of the FCU's board of directors) over-the-counter sales of financial options contracts by the parent, subsidiary, or affiliated entity to a Federal credit union.

(vii) "Put" means a financial options contract which entitles the holder to sell, entirely at the holder's option, a specified quantity of a security at a specified price at any time until the stated expiration date of the contract.

(2) *Permitted Options Transactions.* A Federal credit union may, to manage risk of loss through a decrease in value of its commitments to originate real estate loans at specified interest rates, enter into long put positions on GNMA, FNMA, and FHLMC securities:

(i) if the real estate loans are to be sold on the secondary market within ninety (90) days of closing;

(ii) if the positions are entered into: (A) through a contract market designated by the Commodity Futures Trading Commission for trading such contracts, or (B) with a primary dealer in Government securities;

(iii) if the positions are entered into pursuant to written policies and procedures which are approved by the Federal credit union's board of directors, and include, at a minimum: (A) the Federal credit union's strategy in using financial options contracts and its analysis of how the strategy will reduce sensitivity to changes in price or interest rates in its commitments to originate real estate loans at specified interest rates; (B) a list of brokers or other intermediaries through which positions may be entered into; (C) quantitative limits (e.g., position and stop loss limits) on the use of financial options contracts; (D) identification of the persons involved in financial options contract transactions, including a description of these persons' qualifications, duties, and limits of authority, and description of the procedures for segregating these persons' duties, (E) a requirement for written reports for review by the Federal credit union's board of directors at its monthly meetings, or by a committee appointed by the board on a monthly basis, of: (1) the type, amount, expiration date, correlation, cost of, and current or projected income or loss from each position closed since the last board review, each position currently open and current gains or losses from such positions, and each position planned to be entered into prior to the next board review; (2) compliance with limits established on the policies and procedures; and (3) the extent to which the positions described contributed to reduction of sensitivity to changes in prices or interest rates in the Federal credit union's commitments to originate real estate loans at a specified interest rate; and

(iv) if the Federal credit union has received written permission from the appropriate NCUA Regional Director to engage in financial options contracts transactions in accordance with this § 701.21(i) and its policies and procedures as written.

(3) *Recordkeeping and Reporting.*

(i) The reports described in § 701.21 (i)(2)(iii)(E) for each month must be submitted to the appropriate NCUA Regional Office by the end of the following month. This monthly reporting requirement may be waived by the appropriate NCUA Regional Director on a case-by-case basis for those Federal credit unions with a proven record of responsible use of permitted financial options contracts.

(ii) The records described in § 701.21 (i)(2)(iii)(E) must be retained for two years from the date the financial options contracts are closed.

(4) *Accounting.* A Federal credit union must account for financial options contracts transactions:

(i) in accordance with standards established by the NCUA Board in the Accounting Manual for Federal Credit Unions, available from NCUA, Administrative Office, 1775 Duke Street, Alexandria, VA 22314, or such other instruction as may be deemed appropriate; or

(ii) to the extent not inconsistent with NCUA Board instructions, in accordance with generally accepted accounting standards or principles.

Appendix to Section 701.21(h)—Classifications

Substandard—Loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the credit union will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.

Doubtful—A loan classified doubtful has all the weaknesses inherent in one classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include: proposed merger, acquisition, or liquidation actions, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loss—Loans classified loss are considered uncollectible and of such little value that their continuance as loans is not warranted. This classification does not necessarily mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future.

§ 701.22 Loan Participation.

(a) For purposes of this section:

(1) "Participation loan" means a loan where one or more eligible organizations participates pursuant to a written agreement with the originating lender.

(2) "Eligible organizations" means a credit union, credit union organization, or financial organization.

(3) "Credit union" means any Federal or state chartered credit union.

(4) "Credit union organization" means any organization as determined by the Board, established primarily to serve the daily operational needs of its member credit unions. The term does not include trade associations, membership organizations principally composed of credit unions, or corporations or other businesses which principally provide services to credit union members as opposed to corporations or businesses whose business relates to the daily in-house operation of credit unions.

(5) "Financial organization" means any federally chartered or federally insured financial institution.

(6) "Originating lender" means the participant with which the member contracts.

(b) Subject to the provisions of this section any Federal credit union may participate in making loans with eligible organizations within the limitations of the board of directors' written participation loan policies, PROVIDED:

(1) no Federal credit union shall obtain an interest in a participation loan if the sum of that interest and any (other) indebtedness owing to the Federal credit union by the borrower exceeds 10 per centum of the Federal credit union's unimpaired capital and surplus;

(2) a written master participation agreement shall be properly executed, acted upon by the Federal credit union's board of directors, or if the board has so delegated in its policy, the investment committee or senior management offical(s) and retained in the Federal credit union's office. The master agreement shall include provisions for identifying, either through a document which is incorporated by reference into the master agreement, or directly in the master agreement, the participation loan or loans prior to their sale; and

(3) a Federal credit union may sell to or purchase from any participant the servicing of any loan in which it owns a participation interest.

(c) An originating lender which is a Federal credit union shall:

(1) originate loans only to its members;

(2) retain an interest of at least 10 per centum of the face amount of each loan;

(3) retain the original or copies of the loan documents; and

(4) Require the credit committee or loan officer to use the same underwriting standards for participation loans used for loans that are not being sold in a participation agreement unless there is a participation agreement in place prior to the disbursement of the loan. Where a participation agreement is in place prior to disbursement, either the credit union's loan policies or the participation agreement shall address any variance from non-participation loan underwriting standards.

(d) A participant Federal credit union that is not an originating lender shall:

(1) participate only in loans it is empowered to grant, having a participation policy in place which sets forth the loan underwriting standards prior to entering into a participation agreement;

(2) participate in participation loans only if made to its own members or members of another participating credit union;

(3) retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement; and

(4) obtain the approval of the board of directors or investment committee of the disbursement of proceeds to the originating lender.

§ 701.23 Purchase, Sale, and Pledge of Eligible Obligations.

(a) For purposes of this Section:

(1) "Eligible obligation" means a loan or group of loans;

(2) "Student loan" means a loan granted to finance the borrower's attendance at an institution of higher education or at a vocational school, which is secured by and on which payment of the outstanding principal and interest has been deferred in accordance with the insurance or guarantee of the Federal Government, of a State government, or any agency of either.

(b) Purchase.

(1) A Federal credit union may purchase, in whole or in part, within the limitations of the board of directors' written purchase policies:

(i) Eligible obligations of its members, from any source, if either (A) they are loans it is empowered to grant or (B) they are refinanced with the consent of the borrowers, within 60 days after they are purchased, so that they are loans it is empowered to grant;

(ii) Eligible obligations of a liquidating credit union's individual members, from the liquidating credit union;

(iii) Student loans, from any source, if the purchaser is granting student loans on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary market; and

(iv) Real estate-secured loans, from any source, if the purchaser is granting real estate secured loans pursuant to Section 701.21 on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary mortgage market.

(2) A Federal credit union may make purchases in accordance with this paragraph (b), provided:

(i) the board of directors or investment committee approves the purchase;

(ii) a written agreement and a schedule of the eligible obligations covered by the agreement are retained in the purchaser's office; and for purchases under paragraph (b)(1)(ii) of this section, any advance written approval required by § 741.8 of this chapter is obtained before consummation of such purchase.

(3) The aggregate of the unpaid balance of eligible obligations purchased under paragraph (b) shall not exceed 5 percent of the unimpaired capital and surplus of the purchaser. Student loans purchased in accordance with paragraph (b)(1)(iii), real estate loans purchased in accordance with paragraph (b)(1)(iv), and eligible obligations purchased in accordance with paragraph (b)(1)(i) that are refinanced by the purchaser so that they are loans it is empowered to grant shall not be included in considering this 5 percent limitation.

(c) Sale.

(1) A Federal credit union may sell, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written sale policies, provided:

(i) The board of directors or investment committee approves the sale; and

(ii) A written agreement and a schedule of the eligible obligations covered by the agreement are retained in the seller's office.

(d) Pledge.

(1) A Federal credit union may pledge, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written pledge policies, provided:

(i) The board of directors or investment committee approves the pledge;

(ii) Copies of the original loan documents are retained; and

(iii) A written agreement covering the pledging arrangement is retained in the office of the credit union that pledges the eligible obligations.

(2) The pledge agreement shall identify the eligible obligations covered by the agreement.

(e) Servicing.

A Federal credit union may agree to service any eligible obligation it purchases or sells in whole or in part.

(f) 10 Percent Limitation.

The total indebtedness owing to any Federal credit union by any person, inclusive of retained and reacquired interests, shall not exceed 10 percent of its unimpaired capital and surplus.

§ 701.24 Refund of Interest.

(a) The board of directors of a Federal credit union may authorize an interest refund to members who paid interest to the credit union during any dividend period and who are members of record at the close of business on the last day of such dividend period. Interest refunds may be made for a dividend period only if dividends on share accounts have been declared and paid for that period.

(b) The amount of interest refund to each member shall be determined as a percentage of the interest paid by the member. Such percentage may vary according to the type of extension of credit and the interest rate charged.

(c) The board of directors may exclude from an interest refund: (1) a particular type of ex-

tension of credit; (2) any extension of credit made at a particular interest rate; and (3) any extension of credit that is presently delinquent or has been delinquent within the period for which the refund is being made.

§ 701.25 [Reserved]

§ 701.26 Credit Union Service Contracts.

(a) A Federal credit union may act as a representative of and enter into a contractual agreement with one or more credit unions or other organizations for the purpose of sharing, utilizing, renting, leasing, purchasing, selling, and/or joint ownership of fixed assets or engaging in activities and/or services which relate to the daily operations of credit unions. Agreements must be in writing, and shall advise all parties subject to the agreement that the goods and services provided shall be subject to examination by the NCUA Board to the extent permitted by law.

(b) Where any agreement calls for, or requires, the payment in advance of the actual or estimated charges for more than 3 months such payment shall be deemed an investment in a credit union service organization and subject to the limitations delineated in Sections 107(7)(I) and 107(5)(D) of the Federal Credit Union Act (12 U.S.C. Sections 1757(7)(I) and 1757(5)(D)).

§ 701.27 Investments in and Loans to Credit Union Service Organizations.

(a) *Scope.* Sections 107(7)(I) and 107(5)(D) of the Federal Credit Union Act (12 U.S.C. 1757(7)(I) and 1757(5)(D)) authorize Federal credit unions to invest in and make loans to credit union service organizations. This regulation implements those sections by addressing various issues, including monetary limits on loans and investments, the structure of credit union service organizations, their customer base, and the range of services and activities that they may provide. The regulation also establishes prudential standards for Federal credit union involvement with credit union service organizations, through provisions concerning conflicts of interest, accounting practices, and NCUA access to books and records. The regulation applies only in cases where one or more Federal credit unions have invested in or made loans to an organization pursuant to Section 107(7)(I) or 107(5)(D). The regulation does not regulate credit union service organizations directly but rather establishes conditions of Federal credit union investments in and loans to such organizations.

(b) *Limits imposed by the Federal Credit Union Act.*

(1) Section 107(7)(I) of the Act:

(i) Authorizes a Federal credit union to invest in shares, stocks or obligations of credit union service organizations in amounts not exceeding, in the aggregate, 1% of the credit union's paid-in and unimpaired capital and surplus;

(ii) Limits credit union service organizations to providing services associated with the routine operations of credit unions; and

(iii) Prohibits a Federal credit union from utilizing this authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility, or other similar organization.

(2) Section 107(5)(D) of the Act:

(i) Authorizes a Federal credit union to make loans to credit union service organizations in amounts not exceeding, in the aggregate, 1% of its paid-in and unimpaired capital and surplus (this is independent of the 1% investment limit pursuant to Section 107(7)(I);

(ii) Requires that credit union service organizations exist primarily to meet the needs of their member credit unions; and

(iii) Limits credit union service organizations to business relating to the daily operations of the credit unions they serve.

(c) Definitions.—(1) *Affiliated credit unions* means those credit unions that have either invested in or made loans to a credit union service organization.

(2) *Official* means any director or committee member.

(3) *Immediate family member* means a spouse or other family members living in the same household.

(4) *Paid-in and unimpaired capital and surplus* means shares and undivided earnings.

(5) *Senior management employee* means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(d) *Regulatory provisions.*—(1) *Limits on funding.* A Federal credit union by itself, with other credit unions and/or with non-credit union parties, may invest in and/or loan to a credit union service organization. A Federal credit union's investments in credit union service organizations may not exceed, in the aggregate, 1% of the Federal credit union's paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. A Federal credit union's loans to credit union service organizations may not exceed, in the aggregate, 1% of the Federal credit union's paid-in and unimpaired capital and surplus as of its last calendar year-end financial report.

(2) *Structure.* A Federal credit union may invest in or loan to a credit union service organization only if the organization is structured as either a corporation or limited partnership.

(i) *Corporation.* A credit union service organization chartered as a corporation must be adequately capitalized and operated as a separate entity. A Federal credit union investing in or making loans to such a corporation must take those steps necessary to ensure that it will not be held liable for obligations of the corporation.

(ii) *Limited partnership.* A Federal credit union may participate only as a limited partner in a credit union service organization structured as a limited partnership. As a limited partner, the Federal credit union must not engage in those activities (e.g., control, management, decision-making), which, under state law, would cause the credit union to lose its status as limited partner, and correspondingly its limited liability, and be treated as a general partner.

(3) *Legal opinion.* A Federal credit union making an investment in or loan to a credit union service organization must obtain written legal advice as to whether the credit union service organization is established in a manner that will limit the credit union's potential exposure to no more than the loss of funds invested in or lent to the credit union service organization.

(4) *Customer base.* A Federal credit union may invest in or loan to a credit union service organization only if the organization primarily serves credit unions and/or the membership of affiliated credit unions (as defined in paragraph (c)(1) of this section).

(5) *Permissible services and activities.* A Federal credit union may invest in and/or loan to those credit union service organizations that provide only one or more of the following services and activities:

(i) *Operational services.* Credit card and debit card services; check cashing and wire transfers; internal audits for credit unions; ATM services; EFT services; accounting services; data processing; shared credit union branch (service center) operations; sale of repossessed collateral; management, development, sale or lease of fixed assets; sale, lease or servicing of computer hardware or software; management and personnel training and support; payment item processing; locator services; marketing services; research services; record retention and storage; microfilm and microfiche services; alarm-monitoring and other security services; debt collection services; credit analysis; consumer mortgage loan origination; loan processing, servicing and sales; coin and currency services; provision of forms and supplies.

(ii) *Financial services.* Financial planning and counseling; retirement counseling; investment counseling; securities brokerage services; estate planning; income tax preparation; acting as administrator for prepaid legal service plans; developing and administering IRA, Keogh, deferred compensation, and other personnel benefit plans; trust services; acting as trustee, guardian, conservator, estate administrator, or in any other fiduciary capacity; real estate brokerage services; travel agency services; agency for sale of insurance; personal property leasing; and provision of vehicle warranty programs.

(iii) *NCUA approval of other services.* Any service or activity which is not authorized in paragraph (d)(5) (i) or (ii) of this section must receive NCUA Board approval before a Federal credit union may invest in and/or loan to the credit union service organization that offers the service or activity. Any request for NCUA Board approval of a new service or activity should include a full explanation and complete documentation of the service or activity and how that service or activity is associated with routine credit union operations. The request should be submitted to the appropriate NCUA Regional Office. The request will be treated as a petition to amend paragraph (d)(5) (i) or (ii) of this section and NCUA will request public comment or otherwise act on the petition within 60 days after receipt.

(6) *Conflict of interest.* (i) Individuals who serve as officials of, or senior management employees of, an affiliated Federal credit union

(as defined in paragraph (c)(1) of this section), and immediate family members of such individuals, may not receive any salary, commission, investment income, or other income or compensation from a credit union service organization either directly or indirectly, or from any person being served through the credit union service organization. This provision does not prohibit an official or senior management employee of a Federal credit union from assisting in the operation of a credit union service organization, provided the individual is not compensated by the credit union service organization. Further, the credit union service organization may reimburse the Federal credit union for the services provided by the individual.

(ii) The prohibition contained in paragraph (d)(6)(i) of this section also applies to any employee not otherwise covered if the employee is directly involved in dealing with the credit union service organization unless the board of directors determines that the employee's position does not present a conflict of interest.

(iii) All transactions with business associates or family members not specifically prohibited by this paragraph (d)(6) must be conducted at arm's length and in the interest of the credit union.

(7) *Accounting procedures; access to information*—(i) *Federal credit union accounting.* A Federal credit union must follow generally accepted accounting principles (GAAP) in its involvement with credit union service organizations.

(ii) *Credit union service organization accounting; audits and financial statements; NCUA access to books and records.* An affiliated Federal credit union must obtain written agreements from a credit union service organization, prior to investing in or lending to the organization, that the organization will:

(A) Follow GAAP.

(B) Render financial statements (balance sheet and income statement) at least quarterly and obtain a Certified Public Accountant audit annually and provide copies of such to the affiliated Federal credit union, and

(C) Provide the NCUA Board, or its representatives, with complete access to any books and records of the credit union service organization, as deemed necessary by the Board in carrying out its responsibilities under the Federal Credit Union Act.

(8) *Preexisting credit union service organizations.*

(i) Any Federal credit union investments in existence prior to the effective date of this regulation, May 27, 1986, must conform with this regulation not later than May 27, 1987, unless the NCUA Board grants its prior approval to continue such investment for a stated period.

(ii) Any Federal credit union loans in existence prior to the effective date of this regulation must conform with this regulation not later than May 27, 1987, unless:

(A) The NCUA Board grants its prior approval to continue the loan for a stated period, or

(B) Under the terms of its loan agreement the Federal credit union cannot require accelerated repayment without breaching the agreement.

(e) Other laws. A credit union service organization must comply with applicable Federal, state and local laws.

§§ 701.28–701.29 [Reserved]

§ 701.30 Safe Deposit Box Service.

A Federal credit union may lease safe deposit boxes to its members.

§ 701.31 Nondiscrimination Requirements.

(a) *Definitions:* As used in this part, the term:

(1) "application" carries the meaning of that term as defined in 12 C.F.R. 202.2(f) (Regulation B), which is as follows: "An oral or written request for an extension of credit that is made in accordance with procedures established by a creditor for the type of credit requested";

(2) "dwelling" carries the meaning of that term as defined in 42 U.S.C. 3602(b) (Fair Housing Act), which is as follows: "Any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for the construction or location thereon of any building, structure, or portion thereof"; and

(3) "real estate-related loan" means any loan for which application is made to finance or refinance the purchase, construction, improvement, repair, or maintenance of a dwelling.

(b) *Nondiscrimination in Lending:*

(1) A Federal credit union may not deny a real estate-related loan, nor may it discriminate

in setting or exercising its rights pursuant to the terms or conditions of such a loan, nor may it discourage an application for such a loan, on the basis of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With regard to a real estate-related loan, a Federal credit union may not consider a lending criterion or exercise a lending policy which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) Consideration of any of the following factors in connection with a real estate-related loan is not necessary to a Federal credit union's business, generally has a discriminatory effect, and is therefore prohibited:

(i) the age or location of the dwelling;

(ii) zip code of the applicant's current residence;

(iii) previous home ownership;

(iv) the age or location of dwellings in the neighborhood of the dwelling;

(v) the income level of residents in the neighborhood of the dwelling;

Guidelines concerning possible exceptions to this provision appear in paragraph (e)(2) of this section.

(c) *Nondiscrimination in Appraisals:*

(1) A Federal credit union may not rely upon an appraisal of a dwelling if it knows or should know that the appraisal is based upon consideration of the race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18) of:

(i) any applicant or joint applicant;

(ii) any person associated, in connection with a real estate-related loan application, with an applicant or joint applicant;

(iii) the present or prospective owners, lessees, tenants, or occupants of the dwelling for which a real estate-related loan is requested;

(iv) the present or prospective owners, lessees, tenants, or occupants of other dwellings in the vicinity of the dwelling for which a real estate-related loan is requested.

(2) With respect to a real estate-related loan, a Federal credit union may not rely upon an appraisal of a dwelling if it knows or should know that the appraisal is based upon consideration of a criterion which has the effect of discriminating on the basis of race, color, national origin, religion, sex, handicap, or familial status (having children under the age of 18). Guidelines concerning possible exceptions to this provision appear in paragraph (e)(1) of this section.

(3) A Federal credit union may not rely upon an appraisal that it knows or should know is based upon consideration of any of the following criteria, for such criteria generally have a discriminatory effect, and are not necessary to a Federal credit union's business:

(i) the age or location of the dwelling;

(ii) the age or location of dwellings in the neighborhood of the dwelling;

(iii) the income level of the residents in the neighborhood of the dwelling.

(4) Notwithstanding paragraph (c)(3) of this section, it is recognized that there may be factors concerning location of the dwelling which can be properly considered in an appraisal. If any such factor(s) is relied upon, it must be specifically documented in the appraisal, accompanied by a brief statement demonstrating the necessity of using such factor(s). Guidelines concerning the consideration of location factors appear in paragraph (e)(3) of this section.

(5) Each Federal credit union shall make available, to any requesting member/applicant, a copy of the appraisal used in connection with that member's real estate-related loan application. The appraisal shall be available for a period of 25 months after the applicant has received notice from the Federal credit union of the action taken by the Federal credit union on the real estate-related loan application.

(d) *Nondiscrimination in Advertising:*

(1) *Advertising notice of nondiscrimination compliance.*

(i) No Federal credit union may directly or indirectly engage in any form of advertising of real estate-related loans which implies or suggests that the Federal credit union discrimi-

nates in violation of the provisions of the Fair Housing Act or of this section. Advertisements of such loans shall include a facsimile of the following:

We Do Business in Accordance With the Federal Fair Housing Law and the Equal Credit Opportunity Act

(ii) Advertisements of real estate-related loans which are broadcast on the radio shall contain the following statement: "The (insert name) Federal Credit Union is an equal housing lender."

(2) *Lobby notice of nondiscrimination compliance.* Every Federal credit union which engages in real estate-related lending shall conspicuously display in the public lobby of such credit union and in the public area of each office where such loans are made, in a manner so as to be clearly visible to the general public entering such lobby or area, a notice that incorporates a facsimile of the logotype and notice appearing in paragraph (d)(3) of this section. Posters containing this notice and logotype may be obtained from the Regional Offices of the National Credit Union Administration.

(3) *Logotype and notice of nondiscrimination compliance.* The logotype and text of the notice required in paragraph (d)(2) of this section shall be as follows:

We Do Business in Accordance With the Federal Fair Lending Laws

UNDER THE FEDERAL FAIR HOUSING ACT, IT IS ILLEGAL, ON THE BASIS OF RACE, COLOR, NATIONAL ORIGIN, RELIGION, SEX, HANDICAP, OR FAMILIAL STATUS (HAVING CHILDREN UNDER THE AGE OF 18), TO:

- Deny a loan for the purpose of purchasing, constructing, improving, repairing or maintaining a dwelling, or deny any loan secured by a dwelling; or
- Discrimination in fixing the amount, interest rate, duration, application procedures or other terms or conditions of such a loan, or in appraising property.

IF YOU BELIEVE YOU HAVE BEEN DISCRIMINATED AGAINST, YOU SHOULD SEND A COMPLAINT TO:

Assistant Secretary for Fair Housing and Equal Opportunity
Department of Housing & Urban Development
Washington, D.C. 20410
For processing under the Federal Fair Housing Act
and to:
National Credit Union Administration
Office of Examination and Insurance
1775 Duke Street
Alexandria, VA 22314–3428
For processing under NCUA Regulations

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UNDER THE EQUAL CREDIT OPPORTUNITY ACT, IT IS ILLEGAL TO DISCRIMINATE IN ANY CREDIT TRANSACTION:

- On the basis of race, color, national origin, religion, sex, marital status, or age
- Because income is from public assistance, or
- Because a right was exercised under the Consumer Credit Protection Act.

IF YOU BELIEVE YOU HAVE BEEN DISCRIMINATED AGAINST, YOU SHOULD SEND A COMPLAINT TO:

National Credit Union Administration
Office of Examination and Insurance
1775 Duke Street
Alexandria, VA 22314–3428

(e) *Guidelines:*

(1) Compliance with the Fair Housing Act is achieved when each loan applicant's creditworthiness is evaluated on an individual basis, without presuming that the applicant has certain characteristics of a group. If certain lending policies or procedures do presume group characteristics, they may violate the Fair Housing Act, even though the characteristics are not based upon race, color, sex, national origin, religion, handicap, or familial status. Such a violation occurs when otherwise facially nondiscriminatory lending procedures (either general lending policies or specific criteria used in reviewing loan applications) have the effect of making real estate-related loans unavailable or less available on the basis of race, color, sex, national origin, religion, handicap, or familial status. Note, however, that a policy or criterion which has a discriminatory effect is not a violation of

the Fair Housing Act if its use achieves a legitimate business necessity which cannot be achieved by using less discriminatory standards. It is also important to note that the Equal Credit Opportunity Act and Regulation B prohibit discrimination, either per se or in effect, on the basis of the applicant's age, marital status, receipt of public assistance, or the exercise of any rights under the Consumer Credit Protection Act.

(2) Paragraph (b)(3) of this section prohibits consideration of certain factors because of their likely discriminatory effect and because they are not necessary to make sound real estate-related loans. For purposes of clarification, the prohibited use of location factors in this section is intended to prevent abandonment of areas in which a Federal credit union's members live or want to live. It is not intended to require loans in those areas that are geographically remote from the FCU's main or branch offices or that contravene the parameters of a Federal credit union's charter. Further. this prohibition does not preclude requiring a borrower to obtain flood insurance protection pursuant to the National Flood Insurance Act and Part 760 of NCUA's Rules and Regulations, nor does it preclude involvement with Federal or state housing insurance programs which provide for lower interest rates for the purchase of homes in certain urban or rural areas. Also, the legitimate use of location factors in an appraisal does not constitute a violation of the provision of paragraph (b)(3) of this section, which prohibits consideration of location of the dwelling. Finally, the prohibited use of prior home ownership does not preclude a Federal credit union from considering an applicant's payment history on a loan which was made to obtain a home. Such action entails consideration of the payment record on a previous loan in determining creditworthiness; it does not entail consideration of prior home ownership.

(3)(i) Paragraph (c)(3) of this section prohibits consideration of the age or location of a dwelling in a real estate-related loan appraisal. These restrictions are intended to prohibit the use of unfounded or unsubstantiated assumptions regarding the effect upon loan risk of the age of a dwelling or the physical or economic characteristics of an area. Appraisals should be based on the present market value of the property offered as security (including consideration of specific improvements to be made by the borrower) and the likelihood that the property will retain an adequate value over the term of the loan.

(ii) The term "age of the dwelling" does not encompass structural soundness. In addition, the age of the dwelling may be used by an appraiser as a basis for conducting further inspections of certain structural aspects of the dwelling. Paragraph (c)(3) of this section does, however, prohibit an unsubstantiated determination that a house over X years in age is not structurally sound.

(iii) With respect to location factors, paragraph (c)(4) of this section recognizes that there may be location factors which may be considered in an appraisal, and requires that the use of any such factors be specifically documented in the appraisal. These factors will most often be those location factors which may negatively affect the short range future value (up to 3–5 years) of a property. Factors which in some cases may cause the market value of a property to decline are recent zoning changes or a significant number of abandoned homes in the immediate vicinity of the property. However, not all zoning changes will cause a decline in property values, and proximity to abandoned buildings may not affect the market value of a property because the cause of abandonment is unrelated to high risk. Proper considerations include the condition and utility of the improvement and various physical factors such as street conditions, amenities such as parks and recreation areas, availability of public utilities and municipal services and exposure to flooding and land faults.

§ 701.32 Payment on shares by public units and nonmembers.

(a) *Authority.* A Federal credit union may, to the extent permitted under Section 107(6) of the Act and this section, receive payments on shares, (regular shares, share certificates, and share draft accounts) from public units and political subdivisions thereof (as those terms are defined in § 745.1) and nonmember credit unions, and to the extent permitted under the Act, this section and § 701.34, receive payments on shares (regular shares, share certificates, and share draft accounts) from other nonmembers.

(b) *Limitations.* (1) Unless a greater amount has been approved by the Regional Director, the maximum amount of all public unit and

nonmember shares shall not, at any given time, exceed 20% of the total shares of the federal credit union or $1.5 million, whichever is greater.

(2) Before accepting any public unit or nonmember shares in excess of 20% of total shares, the board of directors must adopt a specific written plan concerning the intended use of these shares and forward a copy of the plan to the Regional Director. The plan must include:

(i) A statement of the credit union's needs, sources and intended uses of public unit and nonmember shares;

(ii) Provision for matching maturities of public unit and nonmember shares with corresponding assets, or justification for any mismatch; and

(iii) Provision for adequate income spread between public unit and nonmember shares and corresponding assets.

(3) A federal credit union seeking an exemption from the limits of paragraph (b)(1) of this section must submit to the Regional Director a written request including:

(i) The new maximum level of public unit and nonmember shares requested, either as a dollar amount or a percentage of total shares;

(ii) The current plan adopted by the credit union's board of directors concerning the use of new public unit and nonmember shares;

(iii) A copy of the credit union's latest financial statement; and

(iv) A copy of the credit union's loan and investment policies.

(4) Where the financial condition and management of the credit union are sound and the credit union's plan for the funds is reasonable, there will be a presumption in favor of granting the request. When granted, exemptions will normally be for a two-year period. The Regional Director will provide a written explanation for an exemption that is granted for a lesser time period.

(5) The Regional Director will provide a written determination on an exemption request within 30 calendar days after receipt of the request. The 30-day period will not begin to run until all necessary information has been submitted to the Regional Director. All denials may be appealed to the NCUA Board in a timely manner. Appeals should be submitted through the Regional Director.

(6) Upon expiration of an exemption, nonmember shares currently in the credit union in excess of the limits established pursuant to (b)(1) of this section will continue to be insured by the National Credit Union Insurance Fund within applicable limits. No new shares in excess of the limits established pursuant to (b)(1) of this section shall be accepted. Existing share certificates in excess of the limits established pursuant to (b)(1) of this section may remain in the credit union only until maturity.

(c) The limitations herein do not apply to accounts maintained in accordance with 701.37 (Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government) and matching funds required by 705.7(b) (Community Development Revolving Loan Program for Credit Unions). Once a loan granted pursuant to Part 705 is repaid, nonmember share deposits accepted to meet the matching requirement are subject to this section.

§ 701.33 Reimbursement, Insurance, and Indemnification of Officials and Employees.

(a) *Official.* An "official" is a person who is or was a member of the board of directors, credit committee or supervisory committee, or other volunteer committee established by the board of directors.

(b) *Compensation.*

(1) Only one board officer, if any, may be compensated as an officer of the board. The bylaws must specify the officer to be compensated, if any, as well as the specific duties of each of the board officers. No other official may receive compensation for performing the duties or responsibilities of the board or committee position to which the person has been elected or appointed.

(2) For purposes of this section, the term "compensation" specifically excludes:

(i) payment (by reimbursement to an official or direct credit union payment to a third party) for reasonable and proper costs incurred by an official in carrying out the responsibilities of the position to which that person has been elected or appointed, if the payment is determined by the board of directors to be necessary or appropriate in order to carry out the official business of the credit union, and is in accordance with written policies and procedures, including documentation requirements, established by the board of directors. Such payments may include the payment of travel costs for officials and one immediate family member per official;

(ii) provision of reasonable health, accident and related types of personal insurance protection, supplied for officials at the expense of the credit union: *Provided,* that such insurance protection must exclude life insurance; must be limited to areas of risk, including accidental death and dismemberment, to which the official is exposed by reason of carrying out the duties or responsibilities of the official's credit union position; must cease immediately upon the insured person's leaving office, without providing residual benefits other than from pending claims, if any; and

(iii) indemnification and related insurance consistent with paragraph (c) of this Section.

(c) *Indemnification.*

(1) A Federal credit union may indemnify its officials and current and former employees for expenses reasonably incurred in connection with judicial or administrative proceedings to which they are or may become parties by reason of the performance of their official duties.

(2) Indemnification shall be consistent either with the standards applicable to credit unions generally in the state in which the principal or home office of the credit union is located, or with the relevant provisions of the Model Business Corporation Act. A Federal credit union that elects to provide indemnification shall specify whether it will follow the relevant state law or the Model Business Corporation Act. Indemnification and the method of indemnification may be provided for by charter or bylaw amendment, contract or board resolution, consistent with the procedural requirements of the applicable state law or the Model Business Corporation Act, as specified. A charter or bylaw amendment must be approved by the National Credit Union Administration.

(3) A Federal credit union may purchase and maintain insurance on behalf of its officials and employees against any liability asserted against them and expenses incurred by them in their official capacities and arising out of the performance of their official duties to the extent such insurance is permitted by the applicable state law or the Model Business Corporation Act.

§ 701.34 Designation of low-income status; receipt of secondary capital accounts by low-income designated credit unions.

(a) *Designation of low-income status.* (1) Section 107(6) of the Federal Credit Union Act (12 U.S.C. 1757(6)) authorizes federal credit unions serving predominantly low-income members to receive shares, share drafts and share certificates from nonmembers. In order to utilize this authority, a federal credit union must receive a low-income designation from its Regional Director. The designation may be removed by the Regional Director upon notice to the federal credit union if the definitions set forth in paragraphs (a) (2) and (3) of this section are no longer met. Removals may be appealed to the NCUA Board within 60 days. Appeals should be submitted through the Regional Director.

(2) The term "low-income members" shall mean those members who make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or those members whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau or those members otherwise defined as low-income members as determined by order of the NCUA Board.

(i) In documenting its low-income membership, a credit union that serves a geographic area where a majority of residents fall at or below the annual income standard is presumed to be serving predominantly low-income members. In applying the standards, Regional Directors shall make allowances for geographical areas with higher costs of living. The following is the exclusive list of geographic areas with the differentials to be used:

	Percent
Hawaii	40
Alaska	36
Washington, DC	19
Boston	17
San Diego	15
Los Angeles	14
New York	13
San Francisco	13
Seattle	10
Chicago	7
Philadelphia	7

(ii) The term "low-income member" also includes those members who are enrolled as full-time or part-time students in a college, university, high school, or vocational school.

(3) The term "predominantly" is defined as a simple majority.

(b) *Receipt of secondary capital accounts by low-income designated credit unions.* A Federal

credit union having a designation of low income status pursuant to paragraph (a) of this section may offer secondary capital accounts to nonnatural person members and nonnatural person nonmembers on the following conditions:

(1) Prior to offering secondary capital accounts, the credit union shall adopt, and forward to the appropriate NCUA Regional Director, a written plan for use of the funds in the secondary capital accounts and subsequent liquidity needs to meet repayment requirements upon maturity of the accounts.

(2) The secondary capital account must be established as a uninsured secondary capital account or other form of non-share account.

(3) The maturity of the secondary capital account must be for a minimum of five years.

(4) The secondary capital account must not be redeemable prior to maturity.

(5) The secondary capital account shall not be insured by the National Credit Union Share Insurance Fund or any governmental or private entity.

(6) The secondary capital account holder's claim against the credit union must be subordinate to all other claims including those of shareholders, creditors and the National Credit Union Share Insurance Fund.

(7) Funds in the secondary capital account (including both principal and interest) must be available to cover operating losses realized by the credit union that exceed its net available reserves and undivided earnings (i.e., reserves and undivided earnings exclusive of allowance accounts for loan and investment losses), and to the extent funds are so used, the credit union shall under no circumstances restore or replenish the account. Losses shall be distributed prorata among all secondary capital accounts held by the credit union at the time the losses are realized.

(8) The secondary capital account may not be pledged or provided by the account-holder as security on a loan or other obligation with the credit union or any other party.

(9) In the event of merger or other voluntary dissolution of the credit union, other than merger into another low-income designated credit union, the secondary capital accounts will, to the extent they are not needed to cover losses at the time of merger or dissolution, be closed and paid out to the account-holder.

(10) A secondary capital account contract agreement must be executed between an authorized representative of the account holder and the credit union accurately establishing the terms and conditions of this section and containing no provisions inconsistent therewith.

(11) A disclosure and acknowledgment as set forth in the Appendix to this section must be provided to and executed by an authorized representative of the secondary capital account holder at the time of entering into the account agreement, and original copies of the account agreement and the disclosure and acknowledgment must be retained by the credit union for the term of the agreement.

(c) *Accounting treatment; weighted value for purposes of recognizing capital value of secondary capital accounts.* (1) A low-income designated credit union that issues secondary capital accounts pursuant to paragraph (b) of this section shall record the funds on its balance sheet in an equity account entitled "uninsured secondary capital account." For such accounts with remaining maturities of less than five years, the credit union shall reflect the capital value of the accounts in its financial statement in accordance with the following scale:

(i) Four to less than five years remaining maturity—80 percent.

(ii) Three to less than four years remaining maturity—60 percent.

(iii) Two to less than three years remaining maturity—40 percent.

(iv) One to less than two years remaining maturity—20 percent.

(v) Less than one year remaining maturity—0 percent.

(2) The credit union will reflect the full amount of the secondary capital on deposit in a footnote to its financial statement.

Appendix to § 701.34

Disclosures and acknowledgment in the following form must be provided to any investor in secondary capital accounts in a low-income designated credit union.

An original, signed copy must be retained by the credit union.

Disclosure and Acknowledgment

I, _____ (name of signatory), hereby acknowledge and agree to the following in my capacity as _____ (official position or title) of _____ (name of institutional investor:

• _____ (name of institutional investor) has committed _____ (amount of funds)

to a secondary capital account with _____ (name of credit union).

• The funds committed to the secondary capital account are committed for a period of ____ years and are not redeemable prior to _____.

• The secondary capital account is not a share account and the funds committed to the secondary capital account are not insured by the National Credit Union Share Insurance Fund or any other governmental or private entity.

The funds committed to the secondary capital account and any interest paid to the account may be used by _____ (name of credit union) to cover any and all operating losses that exceed the credit union's net available reserves and undivided earnings exclusive of allowance accounts for loan and investment losses), and in the event the funds are so used _____ (name of credit union) will be under no circumstances restore or replenish those funds to _____ (organization).

• In the event of liquidation of _____ (name of credit union), the funds committed to the secondary capital account shall be *subordinate to all other claims* on the assets of the credit union, including claims of member shareholders, creditors and the National Credit Union Share Insurance Fund.

_____

(Signature)

_____

(Official Title)

§ 701.35 Share, Share Draft, and Share Certificate Accounts.

(a) Federal credit unions may offer share, share draft, and share certificate accounts in accordance with Section 107(6) of the Act (12 U.S.C. § 1757(6)) and the board of directors may declare dividends on such accounts as provided in Section 117 of the Act (12 U.S.C. § 1763).

(b) A Federal credit union shall accurately represent the terms and conditions of its share, share draft, and share certificate accounts in all advertising, disclosures, or agreements, whether written or oral.

(c) A federal credit union may, consistent with this section, parts 707 and 740 of this subchapter, other federal law, and its contractual obligations, determine the types of fees or charges and other matters affecting the opening maintaining and closing of a share, share draft or share certificate account. State laws regulating such activities are not applicable to federal credit unions.

(d) For purposes of this Section, "state law" means the constitution, statutes, regulations, and judicial decisions of any state, the District of Columbia, the several territories and possessions of the United States, and the Commonwealth of Puerto Rico.

§ 701.36 FCU Ownership of Fixed Assets.

(a) *A Federal credit union's ownership in fixed assets shall be limited as described in this chapter.*

(b) *Definitions*—As Used in This Section:

(1) Premises includes any office, branch office, suboffice, service center, parking lot, other facility, or real estate where the credit union transacts or will transact business.

(2) Furniture, Fixtures, and Equipment includes all office furnishings, office machines, computer hardware and software, automated terminals, heating and cooling equipment.

(3) Fixed Assets means premises and furniture, fixtures and equipment as these terms are defined above.

(4) Investments in fixed assets means:

(i) any investment in real property (improved or unimproved) which is being used or is intended to be used as premises;

(ii) any leasehold improvement on premises;

(iii) the aggregate of all capital and operating lease payments pursuant to lease agreements for fixed assets;

(iv) any investment in the bonds, stock, debentures, or other obligations of a partnership or corporation, including any entity described in Section 701.27, holding any fixed assets used by the Federal credit union and any loans to such partnership or corporation; or

(v) any investment in furniture, fixtures and equipment.

(5) Abandoned premises means former Federal credit union premises from the date of relocation to new quarters, and property originally acquired for future expansion for which such use is no longer contemplated.

(6) Immediate family member means a spouse or other family members living in the same household.

(7) Shares mean all savings (regular shares, share drafts, share certificates, other savings) and retained earnings means regular reserve, reserve for contingencies, supplemental reserves, reserve for losses and undivided earnings.

(8) Senior management employee means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(c) *Investment in Fixed Assets.*

(1) No Federal credit union with $1,000,000 or more in assets, without the prior approval of the Administration, shall invest in fixed assets if the aggregate of all such investments exceeds 5 percent of shares and retained earnings.

(2) A Federal credit union shall submit such statement and reports as the NCUA regional director may require in support of any investment in fixed assets in excess of the limit specified above.

(3) If the Administration determines that the proposal will not adversely affect the credit union, an aggregate dollar amount or percentage of assets will be approved for investment in fixed assets. Once such a limit has been approved, and unless otherwise specified by the regional director, a Federal credit union may make future acquisitions of fixed assets, provided the aggregate of all such future investments in fixed assets does not exceed an additional 1 percent of the shares and retained earnings of the credit union over the amount approved.

(4) Federal credit unions shall submit their requests to the NCUA regional office having jurisdiction over the geographical area in which the credit union's main office is located. The regional office shall inform the requesting credit union, in writing, of the date the request was received. If the credit union does not receive notification of the action taken on its request within 45 calendar days of the date the request was received by the regional office, the credit union may proceed with its proposed investment in fixed assets.

(d) *Premises.*

(1) When real property is acquired for future expansion, at least partial utilization should be accomplished within a reasonable period, which shall not exceed 3 years unless otherwise approved in writing by the Administration. After real property acquired for future expansion has been held for 1 year, a board resolution with definitive plans for utilization must be available for inspection by an NCUA examiner.

(2) A Federal credit union shall endeavor to dispose of "abandoned premises" at a price sufficient to reimburse the Federal credit union for its investment and costs of acquisition. Current documents must be maintained reflecting the Federal credit union's continuing and diligent efforts to dispose of "abandoned premises." After "abandoned premises" have been on the Federal credit union's books for 4 years, the property must be publicly advertised for sale. Disposition must occur through public or private sale within 5 years of abandonment, unless otherwise approved in writing by the Administration.

(e) *Prohibited Transactions.*

(1) With the exception of a short-term informal lease agreement (maturity less than 1 year) no Federal credit union may acquire or lease premises without the prior written approval of the Administration from any of the following:

(i) a director, member of the credit committee or supervisory committee, or senior management employee of the Federal credit union, or im-mediate family member of any such individual.

(ii) a corporation in which any director, member of the credit committee or supervisory committee, official, or senior management employee, or immediate family members of any such individual, is an officer or director, or has a stock interest of 10 percent or more.

(iii) a partnership in which any director, member of the credit committee or supervisory committee, or senior management employee, or immediate family members of any such individual, is a general partner, or a limited partner with an interest of 10 percent or more.

(2) The prohibition contained in paragraph (e)(1) also applies to any employee not otherwise covered if the employee is directly involved in investments in fixed assets unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(3) All transactions with business associates or family members not specifically prohibited by

this subsection (e) must be conducted at arm's length and in the interest of the credit union.

§ 701.37 Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government.

(a) *Definitions.*

(1) "Treasury Tax and Loan ("TT&L") Remittance Account" means a nondividend-paying account, the balance of which is subject to the right of immediate withdrawal, established for receipt of payments of Federal taxes and certain United States obligations under United States Treasury Department regulations.

(2) "TT&L Note Account" means an account subject to the right of immediate call, evidencing funds held by depositaries electing the note option under United States Treasury Department regulations.

(3) "Treasury General Account" means an account, established under United States Treasury Department regulations, in which a zero balance may be maintained and from which the entire balance may be withdrawn by the depositor immediately under all circumstances except closure of the credit union;

(4) "U.S. Treasury Time Deposit-Open Account" means a nondividend-bearing account, established under United States Treasury Department regulations, which generally may not be withdrawn until the expiration of 14 days after the date of the United States Treasury Department's written notice of intent to withdraw.

(b) Subject to regulation of the United States Treasury Department, a Federal credit union may serve as a Treasury tax and loan depositary, a depositary of Federal taxes, a depositary of public money, and a financial agent of the United States Government. In serving in these capacities, a Federal credit union may maintain the accounts defined in subsection (a), pledge collateral, and perform the services described under United States Treasury Department regulations for institutions acting in these capacities.

(c) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and a U.S. Treasury Time Deposit-Open Account shall be considered deposits of public funds. Funds held in a TT&L Remittance Account and a TT&L Note Account shall be added together and insured up to a maximum of $100,000 in the aggregate. Funds held in a Treasury General Account and a U.S. Treasury Time Deposit-Open Account shall be added together and insured up to a maximum of $100,000 in the aggregate.

(d) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and U.S. Treasury Time Deposit-Open Account are not subject to the 60-day notice requirement of Article III, section 5(a) of the Federal Credit Union Bylaws.

§ 701.38 Borrowed Funds From Natural Persons.

(a) Federal credit unions may borrow from a natural person, PROVIDED:

(1) The borrowing is evidenced by a signed promissory note which sets forth the terms and conditions regarding maturity, prepayment, interest rate, method of computation, and method of payment;

(2) The promissory note and any advertisement for such funds contains conspicuous language indicating that:

(i) the note represents money borrowed by the credit union;

(ii) the note does not represent shares and, therefore, is not insured by the National Credit Union Share Insurance Fund.

Part 702

Reserves

§ 702.1 Reserves.

Federal credit unions shall establish and maintain such reserves as may be required by the Act, or by regulation, or in special cases by the Board. A Federal credit union which has a Regular Reserve in excess of the greater applicable percent established by Section 116 of the Federal Credit Union Act may transfer the excess to a supplemental reserve or to the Undivided Earnings Account; provided, however, that such transfer is appropriately approved by the board of directors after careful consideration of the financial condition of the credit union, of present and anticipated future reserve needs, and of full and fair disclosure as set forth in § 702.3.

§ 702.2 Regular Reserve.

(a) Each Federal credit union shall establish and maintain a Regular Reserve, as provided by Section 116 of the Federal Credit Union Act. The totals of the Regular Reserve, the Allowance for Loan Losses Account, and the Allowance for Investment Losses shall be combined for determining the applicable percentage of gross income to be transferred to the Regular Reserve.

(b) Charges to the Regular Reserve for loan losses shall be made in accordance with full and fair disclosure and as set forth in the Accounting Manual for Federal Credit Unions.

(c) Charges to the Regular Reserve for losses other than loan losses shall also be subject to the following conditions:

(1) Charges for losses other than loan losses may be made pursuant to authorization of the board of directors if the credit union's ratio of capital to assets is greater than 6 percent and the charge reduces the ratio by no more than 1/2 percent. The board of directors' authorization shall state the amount of and an explanation of the need for the charge. For the purposes of this section, capital is defined as the total of the Regular Reserve, the Allowance for Loan Losses, the Allowance for Investment Losses, Undivided Earnings, and other reserves.

(2) Charges for losses other than loan losses that do not meet the conditions of (1) above must receive the written approval of the regional director for Federal credit unions.

(d) The Board may decrease the reserve requirements as set forth in Section 116 of the Act when, in its opinion, such decrease is necessary or desirable.

§ 702.3 Full and Fair Disclosure Required.

(a) "Full and fair disclosure" is the level of disclosure which a prudent person would provide to a member of a Federal credit union, the National Credit Union Administration, or, at the discretion of the board of directors, a creditor in order to fairly inform any or all of them of the financial condition and the results of operations of the credit union.

(b)(1) Federal credit union financial statements shall provide for full and fair disclosure of all assets, liabilities, and members' equity, including such valuation allowance accounts as may be necessary to present fairly the financial position; and all income and expenses necessary to present fairly the results of operations for the period concerned.

(2) Full and fair disclosure will further be accomplished by (i) selecting one of the accounting bases provided for in the Accounting Manual for Federal Credit Unions which shall be either the modified cash basis or the accrual basis of accounting, and by (ii) use of appropriate financial statements described in the Accounting Manual for Federal Credit Unions, or financial statements of equivalent format.

(c)(1) The maintenance of a valuation allowance for loan losses and investment or other losses shall not eliminate the requirement for transferring a percentage of gross income before the payment of each dividend to the regular reserve as required by Section 116 of the Federal Credit Union Act.

(2) As a minimum, adjustments to the valuation allowance for loan losses shall be made prior to the distribution or posting of any divi-

dend to the accounts of members so that the valuation allowance established fairly presents the value of loans and probable losses for all categories of loans. The valuation allowance must encompass:

(i) Specifically identified doubtful or troubled loans;

(ii) Pools of classified loans;

(iii) Pools of loans (e.g., consumer, credit card, etc.); and

(iv) A general portion for all other loans.

(3)(i) Adjustments to the valuation allowance for loan losses will be recorded in the expense account "Provision for Loan Losses."

(ii) Whenever additions to the valuation allowance for loan losses cause a deficit in the regular reserve account, such deficits shall be transferred first to undivided earnings and, if this shall cause a deficit in undivided earnings, then to other segregations of undivided earnings that may exist, exclusive of the Special Reserve for Losses, should such be required by the Board in accordance with § 702.1 of this Part. The amounts are eligible for return to undivided earnings as provided for in the Accounting Manual for Federal Credit Unions.

(iii) Dividends shall not exceed the amount available for that purpose after provisions have been made for the statutory transfer to the regular reserve account and the removal of any deficit in the regular reserve account.

(d) The Statement of Financial Condition, when presented to members, creditors or to the National Credit Union Administration, shall contain a dual declaration by the treasurer and by the president, or in the absence of the president, by any other officer designated by the board of directors of the reporting credit union to make such declaration, that the report and related financial statements are true and correct to the best of their knowledge and belief and present fairly the financial position and the results of operations for the period covered.

(e) Upon written application by the board of directors of a Federal credit union, the Board may waive, in whole or in part, the requirement for the maintenance of the valuation allowance for loan losses in amounts which are in excess of the statutory requirements of section 116 of the Federal Credit Union Act but are required under paragraph (c)(3)(ii) of this section. Such application shall set forth the justification for the requested waiver and shall be addressed to the appropriate Regional Director.

Part 703

Investment and Deposit Activities

§ 703.1 Scope.

Sections 107(7), 107(8) and 107(15) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8), 1757(15)), set forth those securities, deposits, and other obligations in which Federal credit unions may invest. Included are securities issued or fully guaranteed by the United States Government or any of its agencies, shares of central credit unions and any federally insured credit union, accounts in other federally insured financial institutions, certain mortgages and mortgage-related securities, and other specified investments. This Part interprets several of the provisions of Sections 107(7), 107(8) and 107(15)(B). It also places limits on the types of transactions that Federal credit unions may enter into in connection with the purchase and sale of authorized securities, deposits, and obligations under Sections 107(7), 107(8) and 107(15)(B). This part does not apply to: investments in loans to members and related activities, which are governed by Sections 701.21, 701.22 and 701.23 (12 C.F.R. 701.21, 701.22 and 701.23); to the purchase of real estate-secured loans pursuant to Section 107(15)(A), which is governed by Section 701.23; to investment in credit union service organizations, which is governed by Section 701.27 (12 C.F.R. 701.27); or to investment in fixed assets, which is governed by Section 701.36 (12 C.F.R. 701.36).

§ 703.2 Definitions.

Adjusted trading means any method or transaction used to defer a loss whereby a Federal credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Average life means the weighted average time to principal repayment with the amount of the principal paydowns (both scheduled and unscheduled) as the weights.

Bailment for hire contract means a contract whereby a third party, bank or other financial institution, for a fee, agrees to exercise ordinary care in protecting the securities held in safekeeping for its customers.

Bankers' Acceptance means a time draft that is drawn on and accepted by a bank, and that represents an irrevocable obligation of the bank.

Cash forward agreement means an agreement to purchase or sell a security with delivery and acceptance being mandatory and at a future date in excess of thirty (30) days from the trade date.

Collateralized Mortgage Obligation (CMO) means a multi-class bond issue collateralized by whole loan mortgages or mortgage-backed securities (MBS). CMOs usually consist of four or more classes of bonds which are commonly referred to as "tranches".

Corporate credit union means a credit union that conforms to the definition of "corporate credit union" as contained in Part 704.

Eurodollar deposit means a deposit in a foreign branch of a United States depository institution.

Facility means the home office of a Federal credit union or any suboffice thereof including, but not necessarily limited to, a wire service, telephonic station, or mechanical teller station.

Federal funds transaction means a short-term or open-ended transfer of funds to a Section 107(8) institution.Futures contract means a contract for the future delivery of commodities, including certain government securities, sold on commodities exchanges.

Immediate family member means a spouse or other family members living in the same household.

Market price means the last established price at which a security is sold.

Maturity date means the date on which a security matures, and shall not mean the call date or the average life of the security.

Real Estate Mortgage Investment Conduit (REMIC) means a nontaxable entity formed for the sole purpose of holding a fixed pool of mortgages secured by an interest in real property and issuing multiple classes of interests in the underlying mortgages.

Repurchase transaction means a transaction in which a Federal credit union agrees to purchase a security from a vendor and to resell the same or any identical security to that vendor at a later

date. A repurchase transaction may be of three types:

(1) *Investment-type repurchase transaction* means a repurchase transaction where the Federal credit union purchasing the security takes physical possession of the security, or receives written confirmation of the purchase and a custodial or safekeeping receipt from a third party under a written bailment for hire contract, or is recorded as the owner of the security through the Federal Reserve Book-Entry System;

(2) *Financial institution-type repurchase transaction* means a repurchase transaction with a Section 107(8) institution; and

(3) *Loan-type repurchase transaction* means any repurchase transaction that does not qualify as an investment-type or financial institution-type repurchase transaction.

Residual interest means the remainder cash flows from a CMO or REMIC transaction after payments due bondholders and trust administrative expenses have been satisfied.

Reverse repurchase transaction means a transaction whereby a Federal credit union agrees to sell a security to a purchaser and to repurchase the same or any identical security from that purchaser at a future date and at a specified price.

Section 107(8) institution means an institution in which a Federal credit union is authorized to make deposits pursuant to Section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)), i.e., an institution that is insured by the Federal Deposit Insurance Corporation or is a state bank, trust company or mutual savings bank operating in accordance with the laws of a state in which the Federal credit union maintains a facility.

Security means any security, obligation, account, deposit, or other item authorized for investment by a Federal credit union pursuant to Section 107(7), 107(8), or 107(15)(B) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8), 1757(15)(B)), other than loans to members.

Senior management employee means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

Settlement date means the date originally agreed to by a Federal credit union and a vendor for settlement of the purchase or sale of a security.

Short sale means the sale of a security not owned by the seller.

Standby commitment means a commitment to either buy or sell a security, on or before a future date, at a predetermined price. The seller of the commitment is the party receiving payment for assuming the risk associated with committing either to purchase a security in the future at a predetermined price, or to sell a security in the future at a predetermined price. The seller of the commitment is required to either accept delivery of a security (in the case of a commitment to buy) or make delivery of a security (in the case of a commitment to sell), in either case at the option of the buyer of the commitment.

Stripped Mortgage-Backed Securities (SMBS) means securities that represent unequal proportions of the cash flows of an underlying pool of mortgages. In their purest form, SMBS represent mortgage-backed securities (MBS) that have been converted into interest only (IO) securities, where holders receive 100 percent of the interest cash flows, and principal only (PO) securities, where holders receive 100 percent of the principal cash flows.

Trade date means the date a Federal credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

Yankee Dollar deposit means a deposit in a United States branch of a foreign bank licensed to do business in the state in which it is located, or a deposit in a state-chartered, foreign-controlled bank.

Zero coupon bond means a debt obligation that makes no periodic interest payments but instead is sold at a discount from its face value. The holder of a zero coupon bond realizes the rate of return through the gradual appreciation of the security, which is redeemed at face value on a specified maturity date.

§ 703.3 Investment Policies.

The board of directors of each Federal credit union shall establish written investment policies consistent with the applicable provisions of the Act, NCUA's regulations, and other applicable laws and regulations, and review them at least annually. At a minimum, the written policies shall address the following:

(a) Purposes and objectives of the credit union's investment activities, including a statement whether securities purchased are held for sale, investment, or trading purposes;

(b) Persons or committees to whom investment authority has been delegated and the extent of their authority;

(c) Limits on the amount of funds that may be committed to any particular investment or securities transaction;

(d) Maturity limits;

(e) Interest rate risk (as applicable);

(f) Credit risk (as applicable);

(g) Securities dealers/brokerage firms approved for use by the board of directors together with any limitations that the board has established with respect to the amount of funds that may be placed or invested with any of the approved broker/dealers (as applicable); and

(h) Safekeeping of securities, including a list of safekeeping facilities approved by the credit union's board of directors.

§ 703.4 Authorized Activities.

(a) *General Authority.* A Federal credit union may contract for the purchase or sale of a security provided that:

(1) The delivery of the security is to be made within thirty (30) days from the trade date; and

(2) The price of the security at the time of purchase is the market price.

(b) *Cash Forward Agreements.* A Federal credit union may enter into a cash forward agreement to purchase or sell a security, provided that:

(1) The period from the trade date to the settlement date does not exceed one hundred and twenty (120) days;

(2) If the credit union is the purchaser, it has written cash flow projections evidencing its ability to purchase the security;

(3) If the credit union is the seller, it owns the security on the trade date; and

(4) The cash forward agreement is settled on a cash basis at the settlement date.

(c) *Loans, Shares and Deposits—Other Financial Institutions.* A Federal credit union may invest in the following accounts of other financial institutions as specified in Sections 107(7) and 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(7), 1757(8)): loans to nonmember credit unions in an aggregate amount not exceeding 25 percent of the lending credit union's unimpaired capital and surplus; shares, share certificates or share deposits of federally insured credit unions; shares or deposits of any central credit union specifically authorized by the board of directors; and deposits of any Section 107(8) institution, provided that where any such deposit, or any portion of it, is not federally insured, a credit union shall analyze the credit quality of the issuing institution prior to making the deposit. Where the deposit, or any portion of it, is not federally insured, a Federal credit union shall also record its credit decision respecting the investment in the records of the credit union.

(d) *Repurchase Transactions.* A Federal credit union may enter into an investment-type repurchase transaction or a financial institution-type repurchase transaction provided the purchase price of the security obtained in the transaction is at or below the market price. A repurchase transaction not qualifying as either an investment-type or financial institution-type repurchase transaction will be considered a loan-type repurchase transaction subject to Section 107 of the Federal Credit Union Act (12 U.S.C. 1757), which generally limits Federal credit unions to making loans only to members.

(e) *Reverse Repurchase Transactions.* A Federal credit union may enter into a reverse repurchase transaction, provided that either any securities purchased with the funds obtained from the transaction or the securities collateralizing the transaction have a maturity date not later than the settlement date for the reverse repurchase transaction. A reverse repurchase transaction is a borrowing transaction subject to Section 107(9) of the Federal Credit Union Act (12 U.S.C. 1757(9)), which limits a Federal credit union's aggregate borrowing to 50 percent of its unimpaired capital and surplus.

(f) *Federal Funds.* A Federal credit union may sell Federal Funds to a Section 107(8) institution, provided that the interest or other consideration received from the financial institution is at the market rate for Federal funds transactions and that the transaction has a maturity of 1 or more business days or the credit union is able to require repayment at any time.

(g) *Yankee Dollars.* A Federal credit union may invest in Yankee Dollar deposits in a Section 107(8) institution.

(h) *Eurodollars.* A Federal credit union mayinvest in Eurodollar deposits in a branch of a Section 107(8) institution.

(i) *Bankers' Acceptances.* A Federal credit union may invest in bankers' acceptances issued by a Section 107(8) institution.

(j) *Mutual Funds.* A Federal credit union may invest in a mutual fund if the investments and investment transactions of the fund are legally

permissible for Federal credit unions under the Federal Credit Union Act and NCUA Rules and Regulations.

§ 703.5 Prohibitions.

The prohibitions contained in paragraphs (f), (h), and (k) of this section shall not apply to securities purchased prior to December 2, 1991. The prohibition contained in paragraph (g) of this section shall not apply to securities purchased prior to July 30, 1993.

(a) Except as provided in Section 701.21(i), a Federal credit union may not purchase or sell a standby commitment.

(b) A Federal credit union may not buy or sell a futures contract.

(c) A Federal credit union may not engage in adjusted trading.

(d) A Federal credit union may not engage in a short sale.

(e) A Federal credit union may not purchase shares or deposits in, or otherwise transact business with a corporate credit union that does not operate in compliance with Part 704 of these rules and regulations in significant respects, or is not examined by NCUA.

(f) Except as provided in paragraph (i) of this section, a Federal credit union may not purchase a Stripped Mortgage-Backed Security (SMBS).

(g)(1) Except as provided in paragraph (i) of this section, a Federal credit union may not purchase a Stripped Mortgage-Backed Security (SMBS).

(i) *Average Life Test.* The CMO or REMIC has an expected average life greater than 10 years.

(ii) *Average Life Sensitivity Test.* The average life of the CMO or REMIC: (A) Extends by more than 4 years, assuming an immediate and sustained parallel shift in the yield curve of plus 300 basis points, or (B) Shortens by more than 6 years, assuming an immediate and sustained parallel shift in the yield curve of minus 300 basis points.

(iii) *Price Sensitivity Test.* The estimated change in the price of the CMO or REMIC is more than 17 percent, due to an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.

(2) The three tests contained in this paragraph (g) shall apply at the time of purchase and on any subsequent retesting date, assuming market interest rates and prepayment speeds at the time that the tests are applied.

(h) Except as provided in paragraph (i) of this section, a Federal credit union may not purchase a residual interest in a CMO or REMIC transaction.

(i) The prohibitions contained in paragraphs (f), (g), and (h) of this section shall not apply where an investment is made solely to reduce interest rate risk and where:

(1) A monitoring and reporting system is in place that provides the documentation necessary to evaluate the expected and actual performance of the investment under different interest rate scenarios;

(2) The monitoring and reporting system is used to conduct and document an analysis that shows, prior to purchase, that the proposed investment will reduce the credit union's interest rate risk;

(3) The investment, subsequent to purchase, is evaluated at least quarterly, to determine whether or not the investment has actually reduced the credit union's interest rate risk;

(4) The investment is reported as a trading asset at market value or as a held-for-sale asset at the lower of cost or market value until its disposition.

(j) The average life and average life sensitivity tests contained in paragraph (g) of this section shall not apply to a floating or adjustable rate CMO/REMIC that has all of the following characteristics at the time of purchase or on a subsequent testing date, irrespective of whether or not it has been purchased to reduce interest-rate risk:

(1) The interest rate of the instrument is reset at least annually.

(2) The interest rate of the instrument, at the time of purchase or at a subsequent testing date, is below the contractual cap of the instrument.

(3) The index upon which the interest rate is based is a conventional widely-used market interest rate such as the London Interbank Offered Rate (LIBOR).

(4) The interest rate of the instrument varies directly (not inversely) with the index upon which it is based and is not reset as a multiple of the change in the related index.

(k) A Federal credit union may not purchase a zero coupon security with a maturity date that is more than 10 years from the settlement date for purchase of the security.

(l) A Federal credit union's directors, officials, committee members, and senior management employees, and immediate family members of such individuals, may not receive pecuniary consider-

ation in connection with the making of an investment or deposit by the Federal credit union. The prohibition contained in this subsection also applies to any employee not otherwise covered if the employee is directly involved in investments or deposits unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(m) All transactions with business associates or family members not specifically prohibited by paragragh (l) must be conducted at arm's length and in the interest of the credit union.

Part 704

Corporate Credit Unions

§ 704.1 Scope.

(a) This Part establishes special rules for all federally insured corporate credit unions and grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this Part, other provisions of NCUA's Rules and Regulations (12 CFR Part 700 et. seq.) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.

(b) The NCUAB has the authority to issue orders which vary from this Part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a).

§ 704.2 Definitions.

"Asset-backed securities" (ABS) means all securities supported by installment loans or leases or by revolving lines of credit. This definition excludes those securities referred to in the financial markets as mortgage-backed securities (MBS) which includes collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs).

"Average daily assets" means the daily average of net assets calculated on the basis of assets at the close of each day in the period.

"Average life" means the weighted average time to principal repayment with the amount of the principal paydowns (both scheduled and unscheduled) as the weights.

"Capital" means the total of all corporate reserves (regular or statutory reserves, as applicable), all undivided earnings, net income, and membership capital share deposit (or equivalent) accounts.

"Capital of a broker/dealer" means the sum of stockholder equity plus subordinated debt which qualifies as capital for regulatory purposes.

"Claims" means loans or other debt obligations.

"Commitments" means any unconditional arrangement that obligates a corporate credit union to extend credit in the form of loans or lease financing receivables; to purchase loans, securities or other assets; or to participate in loans and leases. Commitments also include overdraft facilities, revolving credit, home equity, and mortgage lines of credit, and similar transactions. An obligation is conditional if the corporate credit union is not automatically obligated to extend funds.

"*Corporate credit union*" means an organization that:

(1) Is chartered under Federal or state law as a credit union;

(2) Receives shares from and provides loan services to other credit unions;

(3) Is operated primarily for the purpose of serving other credit unions;

(4) Is designated by the National Credit Union Administration as a corporate credit union;

(5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and

(6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

"Corporate reserves" means regular or statutory reserves, as applicable, excluding all valuation allowances established to meet the full and fair disclosure requirements of Section 702.3 of this Chapter.

"Credit equivalent amounts" means the face amount of each off-balance sheet item multiplied by a credit conversion factor outlined in Appendix B.

"Credit union service organization" (CUSO) means an organization that: (1) exists primarily to meet the needs of credit unions; and (2) engages only in business activities relating to the daily operations of the credit unions it serves or provides services associated with the routine operations of credit unions.

"Expected maturity" means the date on which all remaining principal amounts of an instrument or bond are anticipated to be paid off on the basis of projected payment assumptions.

"Federally issued CMO/REMIC" means a CMO or REMIC which is issued by a U.S. Government

agency or a U.S. Government-sponsored corporation or enterprise.

"Foreign bank" means an institution which is organized under the laws of a country other than the United States, which is engaged in the business of banking, and which is recognized as a bank by the banking supervisory authority of the country in which it is organized.

"Material" means an amount that exceeds 5 percent of the corporate credit union's capital.

"Membership capital share deposit" (MCSD) account means a share, or deposit, or other account that: (1) is established, at a minimum, as a 12-month notice account; (2) is limited to members; (3) is not subject to share insurance coverage by the National Credit Union Share Insurance Fund (NCUSIF) or other deposit insurers; and (4) in the event of liquidation of the corporate credit union, is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured obligations to shareholders and the NCUSIF. In any event, an MCSD account shall not be repayable until notice that the accountholder credit union intends to withdraw MCSD account funds from the corporate credit union, except in the case of a credit union that is placed into liquidation, is purchased and assumed, or is merged. MCSD accounts cannot be used to pledge borrowings. Corporate credit unions that issue MCSD accounts shall disclose, at least annually to their members, the terms and conditions under which such accounts are issued.

"Member reverse repurchase transaction" means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

"Net assets" means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, and member reverse repurchase transactions.

"Non credit union member" means any member of a corporate credit union that is not chartered or licensed as a credit union.

"Original maturity" means the length of time between the date when a commitment is issued and the earliest date on which the corporate credit union can unconditionally cancel the commitment.

"Other reserves" means reserves other than corporate reserves.

"Primary capital" means all corporate reserves and undivided earnings.

"Privately issued CMO/REMIC" means a CMO or REMIC that qualifies as a permissible investment for a federal credit union pursuant to the provisions of Section 107(15)(B) of the Federal Credit Union Act.

"Risk-based capital" means the total of primary capital and secondary capital (up to 100 percent of primary capital).

"Risk-weighted assets" means the sum of total balance sheet assets and off-balance sheet credit equivalent amounts multiplied by their appropriate risk weights.

"SEC-recognized rating agency" means any firm recognized by the Securities and Exchange Commission (SEC) as qualified to assign risk ratings to various instruments required to be registered with the SEC.

"Secondary capital" means MCSD or equivalent accounts (except for MCSD accounts owned by other corporates unless the MCSD account is held by a corporate whose members are primarily other corporates and organizations recognized under Section 501(c)(6) of the Internal Revenue Code), allowance for loan and lease losses up to a maximum of 1.25 percent of risk-weighted assets, and term subordinated debt weighted by remaining maturity as indicated:

1. 5 years or more until maturity—100 percent;

2. 4 to less than 5 years until maturity—80 percent;

3. 3 to less than 4 years until maturity—60 percent;

4. 2 to less than 3 years until maturity—40 percent;

5. 1 to less than 2 years until maturity—20 percent; and

6. Less than 1 year remaining maturity—0 percent.

MCSD accounts upon which the accountholder has given the corporate credit union notice of intent to withdraw may no longer be considered secondary capital.

"Speculative activities" means the use of forwards, options, futures, or similar activities other than when used to reduce interest rate risk.

"Trade association" means an association of organizations or persons formed to promote their common interests. The term includes entities owned or controlled directly or indirectly by such an association but does not include credit unions.

"Term subordinated debt" means debt of a corporate credit union that: (1) is unsecured; (2) is not a deposit; (3) is not insured by the National Credit Union Administration; (4) is subordinated to general creditors and claims of depositors; (5) has an original maturity of at least 7 years; (6) is not redeemable prior to maturity except with the approval of NCUA; (7) is ineligible as collateral for a loan; and (8) is represented by a debt instrument which clearly states that it will absorb losses.

"Undivided earnings" means all forms of retained earnings, except: (1) corporate reserves (regular or statutory reserves, as applicable); and (2) valuation allowances established to meet the full and fair disclosure requirements of Section 702.3 of this Chapter.

"United States depository institutions" means offices or branches (foreign and domestic) of federally insured banks and depository institutions chartered and headquartered in the United States, Puerto Rico, and U.S. territories and possessions. This includes banks, mutual or stock savings banks, savings or building and loan associations, cooperative banks, credit unions, international banking facilities of domestic depository institutions, and U.S. chartered depository institutions owned by entities outside of the United States.

"United States Government or its agencies" means the United States Government or instrumentalities of the United States whose debt obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the United States Government (see Appendix C).

"United States Government-sponsored corporations and enterprises" means agencies originally established or chartered to serve public purposes specified by Congress, but whose obligations are not explicitly guaranteed by the full faith and credit of the United States Government (see Appendix C).

§ 704.3 Planning: Strategic and Business Plans.

(a) The board of directors of a corporate credit union shall adopt a strategic plan with appropriate objectives and goals. This plan will be reviewed periodically during the year to determine that the goals are being accomplished. At least annually, the strategic plan will be reviewed and updated.

(b) A business plan will be prepared for any material expenditure in fixed assets, new products and services, or investments in a CUSO.

§ 704.4 Asset/Liability Management.

(a) *General.* Corporate credit unions shall develop and implement comprehensive written funds management policies.

(b) *Monitoring.* Corporate credit unions shall prepare monthly reports showing the degree of mismatch between the sources and uses of funds for the various timeframes.

§ 704.5 Capital Goals, Objectives and Strategies.

(a) *General.* Corporate credit unions shall adopt formal, written goals (both long-term and short-term), objectives and strategies, including a budgetary process, for the building of capital.

(b) *Impact study.* Where a proposed new service or program, purchase or lease of a fixed asset, or investment in or loan to a CUSO has a material effect on a corporate credit union, the corporate credit union shall perform a cost/benefit analysis of the activity and a study of its impact on the capital position of the corporate credit union.

(c) *Monitoring.* Management will establish monitoring standards and procedures to periodically review and reassess the capital position of the corporate credit union and will document the review.

§ 704.6 Investment.

(a) *Policies.* A corporate credit union shall develop written investment policies which address, at a minimum:

(1) Risk diversification;

(2) Funds management strategies;

(3) Approved investment issuers, instruments, credit limits, credit ratings, and list of permissible institutions;

(4) Approved list of broker/dealers;

(5) Authorization of and limitations on persons/committees making investments; and

(6) Procedures to periodically evaluate the quality of the investment portfolio.

(b) *Limitations.*

(1) Credit Union Service Organizations (CUSOs). The aggregate of all investments in CUSOs shall not exceed 15 percent of a corporate credit union's capital unless permission is obtained from the National Credit Union Administration Board (NCUAB). A corporate credit union is prohibited from utilizing CUSO

authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks or obligations of another financial institution, insurance company, trade association, liquidity facility, or similar organization. Except to the extent that they are inconsistent with this paragraph, a corporate credit union investing in a CUSO shall adhere to the applicable provisions of paragraphs (c)–(e) of Section 701.27 of this Chapter.

(2) Other Investments. Corporate credit unions shall be limited to the following additional investments:

(i) Investments authorized by Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act and Part 703 of this Chapter, except where those authorities are inconsistent with other limitations of this section;

(ii) Deposits in state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;

(iii) Deposits in, the sale of Federal Funds to, and debt obligations of foreign banks subject to the following requirements: (A) the bank must have assets of at least US$ 20 billion, and the investment must be rated not lower than A–1 (or equivalent) for short-term (initial maturity of 1 year or less) investments by an SEC-recognized rating agency, and not lower than AA– (or equivalent) for long-term (initial maturity over 1 year) investments. Short-term investments downgraded below A–2 (or equivalent) and long-term investments downgraded below A– (or equivalent) by the same rating agency used when the investment was purchased, if material in amount, shall be divested; (B) the investment shall be denominated in United States dollars; (C) the country in which the issuing bank is organized shall be rated AAA (or equivalent) for political and economic stability by an SEC recognized rating agency; and (D) aggregate investments in any single foreign bank are limited to not more than 5 percent of the corporate credit union's net assets;

(iv) Debt obligations of U.S. bank holding companies and other U.S. chartered corporations rated not lower than A–1 (or equivalent) for short-term investments (initial maturity of 1 year or less) by an SEC-recognized rating agency and not lower than AA– (or equivalent) for long-term investments (initial maturity over 1 year). Short-term investments downgraded below A–2 (or equivalent) and long-term investments downgraded below A– (or equivalent) by the same rating agency used when the investment was purchased, if material in amount, shall be divested. The total investment in the obligations of any single issuer shall not exceed 5 percent of the corporate credit union's net assets. This authority does not apply to debt obligations that are convertible into the stock of the corporation or holding company;

(v) Asset-backed securities subject to the following requirements: (1) rated not lower than AAA (or equivalent) by an SEC-recognized rating agency; (2) limited to a maximum of 5 percent of the corporate credit union's net assets for any single security or trust; and (3) having an average life at the time of purchase not to exceed 5 years. Asset-backed securities downgraded below AA– (or equivalent) by the same rating agency used when the investment was purchased, if material in amount, shall be divested;

(vi) Federally issued CMOs/REMICs and privately issued CMOs/REMICs as defined in Section 3(a) (41) of the Securities Exchange Act of 1934. CMOs and REMICs are limited further as follows:

(A) *Fixed rate.* An investment in a fixed-rate CMO/REMIC must have an expected average life not to exceed 5 years given an immediate and sustained increase of 300 basis points in mortgage loan commitment rates. This average life standard shall apply at the time of purchase and on any subsequent review date assuming market interest rates and prepayment speeds at the time that the test is applied. A corporate credit union shall use the average of the prepayment estimates of several major securities dealers as the prepayment assumption for the underlying mortgages. In computing the expected average life of a CMO/REMIC investment, it must be assumed that the anticipated rate of prepayment remains constant over the remaining life of the mortgage collateral. This limitation does not apply if principal payments of the investment are specifically matched to principal payments of the corresponding liability.

(B) *Variable rate.* If the CMO/REMIC has a variable interest rate with a cap, then the lesser of the highest interest rate cap or the final interest rate cap during the average life at the time of purchase must be at least 200 basis points above the rate of the corresponding liability that it is matched against. This limitation does not apply if principal payments of the

investment are specifically matched to principal payments of the corresponding liability.

(C) *Divestiture.* Any CMO/REMIC security downgraded below AA– (or equivalent) by the same SEC-recognized rating agency used when the investment was purchased, if material in amount, shall be divested.

(D) *Issuer Limitation.* Privately issued CMO/REMIC securities shall not exceed 5 percent of the corporate credit union's net assets for any single issuer.

(vii) Additional investments provided the corporate credit union has obtained permission from the NCUAB.

(c) *Exclusion.* The requirements of this section to divest investments downgraded below the minimum acceptable ratings do not apply if the expected maturity for the downgraded investment is 3 months or less.

(d) *Divestiture Time Frame.* The corporate credit union has 10 business days to divest itself of any investment that does not comply with the requirements of this section or to request permission from the NCUAB to hold the investment. Any investment acquired before the effective date of this regulation is not subject to this divestiture requirement.

§ 704.7 Lending.

(a) *Policies.* A corporate credit union shall develop written loan policies which address, at a minimum:

(1) Loan types and limits;

(2) Documentation for each loan and line of credit;

(3) Security;

(4) Analysis of financial and operational data;

(5) Monitoring standards; and

(6) Review and reassessment of the credit quality of the borrower.

(b) *General.* Each individual loan or line of credit limit will be determined after analyzing the financial and operational soundness of the applicant and the ability of the applicant to repay the loan. Loans are limited as follows:

(1) *Loans to member credit unions.* The maximum aggregate amount in loans and approved lines of credit to any one member that is a credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF and member reverse repurchase transactions, shall not exceed the corporate credit union's capital or 10 percent of the corporate credit union's shares and capital, whichever is greater;

(2) *Loans to members that are not credit unions.* The aggregate amount of loans and lines of credit to credit union service organizations (CUSOs) and to members other than credit unions shall not exceed 15 percent of the corporate credit union's capital unless permission is obtained from the NCUAB.

(3) *Loans to credit unions that are not members of the corporate credit union.* The aggregate amount of loans to other credit unions that are not members of the corporate credit union shall not exceed 25 percent of the corporate credit union's shares and capital. The maximum aggregate amount in loans and approved lines of credit to any one borrower, excluding pass-through and guaranteed loans from the CLF and the NCUSIF and member reverse repurchase transactions, shall not exceed the corporate credit union's capital or 10 percent of the corporate credit union's shares and capital, whichever is greater. Loans resulting from a loan participation purchased from another corporate credit union are excluded from this 25 percent limitation.

(c) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union and must retain an interest of at least 5 percent of the face amount of the loan. The participation agreement may be executed at any time prior to, during, or after disbursement.

(d) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans made at fixed and variable rates to member credit unions or other organizations.

§ 704.8 Borrowing.

A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. Additional borrowing authority can be obtained from the NCUAB.

§ 704.9 Services.

A corporate credit union may provide services to its members involving investments, liquidity management, payment systems, and correspondent services, unless otherwise prohibited by the

NCUAB, or, in the case of a state-chartered corporate credit union, prohibited by state law. The corporate credit union will maintain written agreements with vendors and other providers of services.

§ 704.10 Fixed Assets.

(a) *General.* A corporate credit union's ownership in fixed assets shall be limited as described in Section 701.36 of this Chapter, except that in lieu of paragraphs (c)(1)–(4) of Section 701.36, paragraph (b) of this section applies.

(b) *Investment in Fixed Assets.*

(1) No corporate credit union, without the prior written approval of the NCUAB, shall invest in fixed assets where the aggregate of all such investments exceeds 15 percent of capital.

(2) A corporate credit union shall submit requests to exceed the limitation of paragraph (b)(1) of this section to the Director, Office of Corporate Credit Unions. Requests shall be supplemented by such statements and reports as the Director, Office of Corporate Credit Unions, may require. If the corporate credit union does not receive notification of the action taken on its request within 45 calendar days of the date the request was received by the Director, Office of Corporate Credit Unions, the corporate credit union may proceed with its proposed investment in fixed assets. If the NCUAB determines that the proposal will not adversely affect the corporate credit union, it will respond in writing and an aggregate dollar amount or percentage of total capital will be approved for investment in fixed assets.

§ 704.11 Corporate Reserves.

(a) *Minimum Capital Ratio.* Each corporate credit union shall maintain a minimum ratio of risk-based capital to risk-weighted assets as follows:

(1) Within 90 days of the effective date of this regulation, primary capital shall be at least 4 percent of risk-weighted assets, or the corporate credit union will develop and implement a plan acceptable to NCUA for achieving an adequate level of primary capital consistent with the provisions of this regulation. This plan shall be submitted to the Director, Office of Corporate Credit Unions.

(2) By January 1, 1994, total capital shall equal at least 8 percent of risk-weighted assets, or the corporate credit union will develop and implement a plan acceptable to NCUA for achieving an adequate level of capital consistent with the provisions of this regulation. This plan shall be submitted to the Director, Office of Corporate Credit Unions.

(b) *Exceptions.* The NCUAB may modify a corporate credit union's reserve requirements under special circumstances.

(c) *Components of risk-based capital.* A corporate credit union's qualifying capital base consists of primary and secondary capital of which at least 50 percent shall be composed of primary capital.

(d) *Limitations.* For purposes of calculating the amount of secondary capital, term subordinated debt shall not exceed 50 percent of secondary capital.

(e) *Procedures.* Balance sheet assets and credit equivalent amounts for off-balance sheet items are assigned to a risk-weight category. The total dollar amount in each category shall be multiplied by the risk-weight assigned to that category. The sum of the categories comprises risk-weighted assets.

(f) *Frequency.* Each corporate credit union shall calculate the ratio of capital to risk-weighted assets each month. A record of such calculation shall be maintained.

(g) *Risk Weights for Balance Sheet Assets.* Each balance sheet asset shall be assigned a risk weight of 0 percent, 20 percent, 50 percent, and 100 percent as indicated in Appendix A.

(h) *Other Considerations.* (1) An investment in the shares of a mutual fund is assigned to the risk category appropriate to the highest risk-weighted asset that the fund is permitted to hold. In addition, if the fund engages in speculative activities as defined in Section 704.2, then investments in the fund will be assigned to the 100 percent risk category.

(2) Accruals will be assigned the risk-weighting of the underlying asset that they represent.

(i) *Credit Conversion Factors for Off-Balance Sheet Items.* Off-balance sheet items will be risk-weighted each month using credit conversion factors as indicated in Appendix B.

(j) *Risk-Based Capital Ratios.* (1) The primary capital ratio is computed by dividing primary capital by total risk-weighted assets.

(2) The total capital ratio is computed by dividing risk-based capital by total risk-weighted assets.

(3) Month-end amounts will be used to calculate corporate credit union capital ratios.

(k) *Required Reserve Transfers.* The amount that a corporate credit union is required to transfer or set aside in corporate reserves is based on both the corporate credit union's primary and total capital ratios. Ranges of capital ratios have been established. These capital ratio ranges are then associated with 1 of 6 corresponding categories in determining the required reserve transfer. To qualify for a lower reserve transfer category, the capital ratios must fall in both the primary and total capital ratio ranges of the applicable category. The corporate credit union shall set aside an amount equal to the appropriate required reserve transfer percentage times the corporate credit union's average daily assets for the transfer period times the number of days in the transfer period divided by 365. Until January 1, 1994, transfers shall be based on the level of primary capital only.

(1) Category 1 requires a corporate reserve transfer percentage of at least 25 basis points of average daily assets when either the primary capital ratio is less than 4.0 percent or the total capital ratio is less than 8.0 percent. A corporate reserve transfer percentage greater than 25 basis points of average daily assets is required if needed to bring either or both of the capital ratios up to the minimum acceptable level, or the corporate credit union would have to obtain approval from the NCUAB to operate below the minimum capital levels.

(2) Category 2 requires a corporate reserve transfer percentage of 20 basis points of average daily assets when the primary capital ratio is greater than 4.0 percent and less than 6.0 percent or the total capital ratio is greater than 8.0 percent and less than 9.0 percent.

(3) Category 3 requires a corporate reserve transfer percentage of 15 basis points of average daily assets when either the primary capital ratio is greater than 6.0 percent and less than 8.0 percent or the total capital ratio is greater than 9.0 percent and less than 12.0 percent.

(4) Category 4 requires a corporate reserve transfer percentage of 10 basis points of average daily assets when either the primary capital ratio is greater than 8.0 percent and less than 10.0 percent or the total capital ratio is greater than 12.0 percent and less than 15.0 percent.

(5) Category 5 requires a corporate reserve transfer percentage of 5 basis points of average daily assets when either the primary capital ratio is greater than 10.0 percent and less than 12.0 percent or the total capital ratio percentage is greater than 15.0 percent and less than 18.0 percent.

(6) Category 6 requires a corporate reserve transfer percentage of 0 basis points when the primary capital ratio is greater than 12.0 percent and the total capital ratio percentage is greater than 18.0 percent.

(l) Corporate credit unions must provide reserves necessary for full and fair disclosure as specified in Section 702.3 of the NCUA Rules and Regulations.

§ 704.12 Representation.

(a) *Board representation.* The board shall be determined as stipulated in the standard corporate federal credit union bylaws governing election procedures, provided that:

(1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;

(2) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;

(3) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other subunits of a state trade association);

(4) For purposes of meeting the requirements of paragraphs (a)(2) and (a)(3) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association;

(5) In the case of a corporate credit union whose membership is composed of more than 25 percent non credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions.

(b) *Representatives of organizational members.* (1) An organizational member of a corporate credit union is a member that is not a natural person. An organizational member may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings, to vote, and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

(2) Any vacancy on the board of a corporate credit union caused by a representative being unable to complete his or her term shall be filled by the board of the corporate credit union according to its bylaws governing the filling of board vacancies.

(c) *Recusal provision.* (1) No director, committee member, officer, or employee of a corporate credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his or her pecuniary interest or the pecuniary interest of any entity (other than the corporate credit union) in which he or she is interested, except if the matter involves general policy applicable to all members, such as setting dividend or loan rates or fees for services.

(2) An individual is "interested" in an entity if he or she:

(i) Serves as a director, officer, or employee of the entity;

(ii) Has a business, ownership, or deposit relationship with the entity; or

(iii) Has a business, financial, or familial relationship with an individual whom he or she knows has a pecuniary interest in the entity.

(3) In the event of the disqualification of any directors, by operation of paragraph (c)(1) of this section, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.

(4) In the event of the disqualification of any committee member by operation of paragraph (c)(1) of this section, the remaining qualified committee members, if constituting a quorum with the disqualified committee members, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.

(d) *Administration.* A corporate credit union shall be under the direction and control of its board of directors. While the board may delegate the performance of administrative duties, the board is not relieved of its responsibility for their performance. The board may employ a chief executive officer who shall have such authority and such powers as delegated by the board to conduct business from day to day. Such chief executive officer must answer solely to the board of the corporate credit union, and may not be an employee of a credit union trade association.

§ 704.13 Annual Audit.

(a) The supervisory committee of a corporate credit union shall cause an annual opinion audit to be made by an independent, duly licensed certified public accountant (CPA) and shall submit the audit report to the board of directors. A summary of the audit report shall be submitted to the membership at the next annual meeting;

(b) A copy of the audit report and reportable conditions letter (i.e., management letter) shall be submitted to the Director, Office of Corporate Credit Unions, within 30 days after receipt by the board of directors.

§ 704.14 Contracts/Written Agreements.

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

§ 704.15 State-Chartered Corporate Credit Unions.

This Part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.

§ 704.16 Effective Date.

This regulation is effective beginning December 2, 1992 or June 29, 1992 if the corporate credit union plans to use the expanded authorities of paragraphs 6, 7, and 8 and has substantially complied with the other provisions of this Part.

§ 704.17 Fidelity Bond Coverage.

(a) *Scope.* This section provides the fidelity bond requirements for employees and officials in corporate credit unions.

(b) *Review of coverage.* The board of directors of each corporate credit union shall, at least annu-

ally, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the mininum requirements in this section.

(c) *Minimum coverage. Approved Forms.* Every corporate credit union will maintain bond coverage with a company holding a certificate of authority from the Secretary of the Treasury. All bond forms, and any riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of the NCUA Board. The Corporate Credit Union Discovery Bond (NCUA 100) and Standard Form 24 with Credit Union Bond Conversion Endorsement are approved for use by corporate credit unions. Credit Union Blanket Bond Form 581 and Form 23—Extended Form, may also be utilized by corporate credit unions. Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, all bonds must include a provision, in a form approved by the NCUA Board, requiring written notification by surety to the Board: (1) When the bond of a credit union is terminated in its entirety; or (2) when bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member. Said notification shall be sent to the Secretary of the NCUA Board or designee and shall include a brief statement of cause for termination.

(d) *Minimum coverage amounts.* The minimum amount of bond coverage will be computed based on the corporate credit union's net assets. The following table lists the minimum requirements.

Net assets	Minimum bond (million)
Less than $50 million	$1.0
$50–$99 million	2.0
$100–$499 million	4.0
$500–$999 million	6.0
$1.0–1.999 billion	8.0
$2.0–$4.999 billion	10.0
$5.0–$9.999 billion	15.0
$10.0–$24.999 billion	20.0
$25.0 billion plus	25.0

It is the duty of the board of directors of each corporate credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond coverage in excess of the above minimums.

(e) *Reduced coverage: NCUA Approval.* Any proposal for reduced coverage must be approved in writing by the NCUA Board at least 20 days in advance of the proposed effective date of the reduction.

(f) *Deductibles.*

(1) The maximum amount of deductibles allowed are based on the corporate credit union's primary capital to risk asset ratio as defined in § 704.11(j)(1). The following table sets out the maximum deductibles.

Primary capital to risk assets ratio	Maximum deductible
Less than 4.0 percent.	7.5 percent of primary capital.
4.0–7.99 percent	10.0 percent of primary capital.
8.0–11.99 percent	12.0 percent of primary capital.
Greater than 12.0 percent.	15.0 percent of primary capital.

(2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those showing in this section must have the written approval of the NCUA Board at least 20 days prior to the effective date of the deductibles.

(g) *Additional coverage.* The NCUA Board may require additional coverage for any corporate credit union when, in the opinion of the Board, current coverage is insufficient. The board of directors of the corporate credit union must obtain additional coverage within 30 days after the date of written notice from the NCUA Board.

Appendix A

Summary of Risk Weights and Risk Categories for Corporate Credit Unions:

Category 1: Zero Percent Risk Weight.

a. Coin and currency on hand or physically in transit.

b. Balances due from and claims on Federal Reserve Banks.

c. Claims on and portions of claims that are unconditionally guaranteed by the U.S. Government or its agencies.

d. Claims collateralized by cash or eligible deposits.

e. CLF subscriptions, including U.S. Central CLF Participation Certificates, and CLF Pass-

Through Loans from the CLF through U.S. Central to the corporate credit unions.

f. Asset Accounts related to Member Reverse Repurchase Agreements without indemnity obligation.

g. Claims on or unconditionally guaranteed by sovereign central governments of "AAA" rated countries.

h. Accrued interest receivable on the above.

Category 2: 20 Percent Risk Weight.

a. Items, other than coin and currency, in process of collection.

b. Claims on or portions of claims guaranteed by U.S. Government-sponsored corporations and enterprises.

c. Claims conditionally guaranteed by the U.S. Government or its agencies or U.S. Government-sponsored corporations and enterprises.

d. Claims or portions of claims including Repurchase Agreements) collateralized by securities issued by the U.S. Government or its agencies or U.S. Government-sponsored corporations and enterprises.

e. General obligation claims on state and local governments located in the United States.

f. Claims on U.S. depository institutions (including Federal Funds sold) subject to the ratings requirements shown below.

g. Claims on depository institutions (including Federal Funds sold) chartered in countries rated AAA other than the United States subject to the ratings requirements shown below.

h. Claims on a corporate credit union.

i. Asset accounts related to Member Reverse Repurchase Agreements with indemnity obligations.

j. Delivery Versus Payment (DVP) Repurchase Transactions in which the corporate receives the securities collateralizing the transactions, and the corporate is authorized to invest in these securities.

k. Tri-party repurchase transactions with broker/dealers having at least $100 million in capital which are collateralized by securities that the corporate credit union is authorized to invest in.

l. Asset-backed securities rated no lower than AAA with remaining weighted average lives of 3 years or less.

m. All CMOs/REMICs (excluding CMOs/REMICs collateralized by whole loan mortgages) that comply with Section 6(b)(2)(vi).

n. Secured loans to credit unions.

o. Accrued Interest Receivable on above.

In order to have a 20 percent risk weighting, U.S. depository institutions and foreign banks must meet one of the following conditions:

(a) The institution has a short-term debt rating not lower than A–2 (or equivalent) by a SEC-recognized rating agency; or

(b) The institution has a long-term debt rating not lower than A– (or equivalent) by a SEC-recognized rating agency; or

(c) The institution has an issuer rating not lower than B/C (or equivalent) by a SEC-recognized rating agency.

Category 3: 50 Percent Risk Weight.

a. Asset-backed securities rated no lower than AAA with remaining weighted average lives greater than 3 years.

b. All CMOs/REMICs collateralized by whole-loan mortgages that qualify under Section 6(b)(2)(vi).

c. Accrued Interest Receivable on the above.

Category 4: 100 Percent Risk Weight for All Other Assets Including, but NOT LIMITED to:

a. Loans to and investments in CUSOs.

b. Unsecured loans to credit unions.

c. All fixed assets, including land, buildings, furniture, fixtures, equipment, automobiles, and leasehold improvements.

d. All Hold-in-Custody Repurchase Agreements.

e. Member Capital Share Deposits (MCSD) in a corporate credit union.

f. Stripped Mortgage-Backed Securities.

g. Residual Interests of CMOs/REMICs.

h. Zero Coupon Securities with a maturity date more than 5 years from the purchase settlement date of the security.

i. Claims on U.S. chartered corporations and bank holding companies, including commercial paper and corporate bonds.

j. Mutual Funds that do not qualify for a lower risk weighting.

k. Prepaid Assets.

l. Accounts Receivable and other receivables.

m. NCUSIF Deposit.

n. Mortgage servicing rights.

o. Intangible assets.

p. Accrued Interest Receivable on the above.

Appendix B

OFF-BALANCE SHEET CREDIT CONVERSION FACTORS

Zero Percent Credit Conversion Factor:

Unused portions of credit lines with original maturities of 6 months or less, or which are unconditionally cancellable.

50 Percent Credit Conversion Factor:

a. Unused portions of credit lines with original maturities exceeding 6 months.

b. Commitments to participate in a loan or loan package.

100 Percent Credit Conversion Factor:

a. Irrevocable standby letters of credit guaranteeing financial performance (including VISA letters of credit issued by corporate credit unions on behalf of their members, or standby letters of credit backing Industrial Revenue Bonds).

b. Forward Commitments to purchase an asset or perform under a lease contract.

c. Securities held in safekeeping loaned with indemnification. Other off-balance sheet items will be addressed on a case-by-case basis by the Director, Office of Corporate Credit Unions.

Appendix C

U.S. Government Obligations and U.S. Government Agencies.

a. U.S. Treasury Bills
b. U.S. Treasury Notes
c. U.S. Treasury Bonds
d. Commodity Credit Corporation
e. Export-Import Bank (Exim Bank)
f. Farm Credit System Financial Assistance Corporation (FCSFAC)
g. Farmers Home Administration (FmHA)
h. Federal Housing Administration (FHA)
i. General Services Administration (GSA)
j. Government National Mortgage Association (GNMA)
k. Maritime Administration (MA)
l. Overseas Private Investment Corporation (OPIC)
m. Small Business Administration (SBA)
n. Veterans Administration (VA)
o. Washington Metropolitan Area Transit Authority (WMATA)

U.S. Government-Sponsored Corporations and Enterprises.

a. Federal Home Loan Bank (FHLB)
b. Federal Home Loan Mortgage Corporation (FHLMC)
c. Federal National Mortgage Association (FNMA)
d. Resolution Trust Corporation (RTC)
e. Student Loan Marketing Association (SLMA)

Part 704

Corporate Credit Unions

§ 704.1 Scope.

(a) This part establishes special rules for all federally insured corporate credit unions. Non federally insured corporate credit unions must agree, by written contract, to both adhere to the requirements of this part and submit to examinations, as determined by NCUA, as a condition of receiving shares or deposits from federally insured credit unions. This part grants certain additional authorities to federal corporate credit unions. Except to the extent that they are inconsistent with this part, other provisions of NCUA's Rules and Regulations (12 CFR chapter VII) and the Federal Credit Union Act apply to federally chartered corporate credit unions and federally insured state-chartered corporate credit unions to the same extent that they apply to other federally chartered and federally insured state-chartered credit unions, respectively.

(b) The Board has the authority to issue orders which vary from this part. This authority is provided under Section 120(a) of the Federal Credit Union Act, 12 U.S.C. 1766(a). Requests by state-chartered corporate credit unions for waivers to this part and for expansions of authority under Appendix B of this part must be approved by the state regulator before being submitted to NCUA.

§ 704.2 Definitions.

Adjusted trading means any method or transaction whereby a corporate credit union sells a security to a vendor at a price above its current market price and simultaneously purchases or commits to purchase from the vendor another security at a price above its current market price.

Asset-backed security means a security that is primarily serviced by the cashflows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to the securityholders. This definition excludes those securities referred to in the financial markets as mortgage-backed securities (MBS), which includes collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs).

Capital means the sum of a corporate credit union's reserves and undivided earnings, paid-in capital, and membership capital.

Capital ratio means the corporate credit union's capital divided by its moving daily average net assets.

Collateralized mortgage obligation (CMO) means a multi-class bond issue collateralized by mortgages or mortgage-backed securities.

Commercial mortgage related security means a mortgage related security where the mortgages are secured by real estate upon which is located a commercial structure.

Corporate credit union means an organization that:

(1) Is chartered under Federal or state law as a credit union;

(2) Receives shares from and provides loan services to credit unions;

(3) Is operated primarily for the purpose of serving other credit unions;

(4) Is designated by NCUA as a corporate credit union;

(5) Limits natural person members to the minimum required by state or federal law to charter and operate the credit union; and

(6) Does not condition the eligibility of any credit union to become a member on that credit union's membership in any other organization.

Correspondent services means services provided by one financial institution to another, and includes check clearing, credit and investment services, and any other banking services.

Credit enhancement means collateral, third-party guarantees, and other features that are designed to provide structural support and protection against losses to investors in a particular security.

Daily average net assets means the average of net assets calculated for each day during the period.

Dealer bid indication means a dealer's approximation of the bid price of a security.

Dollar roll means the purchase or sale of a mortgage backed security to a counterparty with an agreement to resell or repurchase a substantially identical security at a future date and at a specified price.

Embedded option means a characteristic of certain assets and liabilities which gives the issuer of the instrument the ability to change the features such as final maturity, rate, principal amount and average life. Options include, but are not limited to, calls, caps, and prepayment options.

Expected maturity means the date on which all remaining principal amounts of an instrument or bond are anticipated to be paid off on the basis of projected payment assumptions.

Fair value of a financial instrument means the amount at which an instrument could be exchanged in a current arms-length transaction between willing parties, other than in a forced liquidation sale. Market prices, if available, are the best evidence of the fair value of financial instruments. If market prices are not available, the best estimate of fair value may be based on the quoted market price of a financial instrument with similar characteristics or on valuation techniques (for example, the present value of estimated future cash flows using a discount rate commensurate with the risks involved, option pricing models, or matrix pricing models).

Federal funds transaction means a short-term or open-ended unsecured transfer of immediately available funds by one depository institution to another depository institution or entity.

Foreign bank means an institution which is organized under the laws of a country other than the United States, is engaged in the business of banking, and is recognized as a bank by the banking supervisory authority of the country in which it is organized.

Forward settlement of a transaction means settlement on a date other than the trade date.

Immediate family member means a spouse or other family member living in the same household.

Industry recognized information provider means an organization which obtains compensation by providing information to investors and receives no compensation for the purchase or sale of investments.

Long-term investment means, for the purpose of issue ratings, an investment that has an initial maturity, or expected maturity, greater than one year.

Market price means the price at which a security can be bought or sold.

Matched means, with respect to assets and liabilities, that the factors which affect cash flows of an asset are replicated in a corresponding liability.

Member paid-in capital means paid-in capital that: Is held by the corporate credit union's members; and has an initial maturity of at least 20 years. A corporate credit union may not condition membership, services, or prices for services on a credit union's ownership of paid-in capital. When a paid-in capital instrument has a remaining maturity of 5 years, the amount of the instrument that may be considered paid-in capital for the purposes of this part is reduced by a constant monthly amortization which ensures the recognition of paid-in capital is fully amortized when the instrument has a remaining maturity of 3 years. The terms and conditions of any member paid-in capital instrument must be disclosed to the recorded owner of such instrument at the time the instrument is created and at least annually thereafter.

Member reverse repurchase transaction means an integrated transaction in which a corporate credit union purchases a security from one of its member credit unions under agreement by that member credit union to repurchase the same security at a specified time in the future. The corporate credit union then sells that same security, on the same day, to a third party, under agreement to repurchase it on the same date on which the corporate credit union is obligated to return the security to its member credit union.

Membership capital means funds contributed by members which are available to cover losses that exceed reserves and undivided earnings and paid-in capital. In the event of liquidation of the corporate credit union, membership capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders and the National Credit Union Share Insurance Fund (NCUSIF), but excluding paid-in capital. The funds have a minimum withdrawal notice of three years, are not insured by the NCUSIF or other share or deposit insurers, and cannot be used to pledge against borrowings. A member may sell its membership capital to a credit union in the corporate credit union's field of membership, subject to the corporate credit union's approval. The funds may be in the form of a term certificate, or may be in the form of an adjusted balance account. An adjusted balance account may be adjusted in relation to a measure (e.g., one percent of a member credit union's assets) established and disclosed by the corporate credit union at the time the account is

opened without regard to any minimum withdrawal notice period. Upon written notice of intent to withdraw membership capital, the balance of the account will be frozen (no annual adjustment) until the conclusion of the notice period. The terms and conditions of a membership capital account must be disclosed to the recorded owner of such account at the time the account is opened and at least annually thereafter. Upon notification of intent to withdraw, the amount of the account on notice that can be considered membership capital is reduced by a constant monthly amortization which ensures the recognition of membership capital is fully amortized at the end of the notice period. The full balance of a membership capital account that has been placed on notice, not just the remaining non amortized portion, is available to absorb losses in excess of the sum of reserves and undivided earnings and paid-in capital until the funds are released by the corporate credit union at the conclusion of the notice period.

Mortgage related security means a security as defined in Section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), i.e., a privately-issued security backed by mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure.

Mortgage servicing means performing tasks to protect a mortgage investment, including collecting the installment accounts, monitoring and dealing with delinquencies, and overseeing foreclosures and payoffs.

Moving daily average net assets means the average of daily average net assets for the month being measured and the previous 11 months.

NCUA means NCUA Board (Board), unless the particular action has been delegated by the Board.

Net assets means total assets less Central Liquidity Facility (CLF) stock subscriptions, CLF loans guaranteed by the NCUSIF, U.S. Central CLF certificates, and member reverse repurchase transactions. For its own account, a corporate credit union's payables under reverse repurchase agreements and receivables under repurchase agreements may be netted out if the Generally Accepted Accounting Principles (GAAP) conditions for offsetting are met.

Net economic value (NEV) means the fair value of assets minus the fair value of liabilities. All fair value calculations must include the value of forward settlements and embedded options and of off balance sheet financial derivatives, such as futures, options, interest rate swaps, and forward rate agreements. Membership capital is treated as a liability for purposes of this calculation. The NEV ratio is calculated by dividing NEV by the fair value of assets.

Net interest income means the difference between income earned on interest bearing assets and interest paid on interest bearing liabilities.

Non member paid-in capital means paid-in capital that is approved by NCUA, upon application by the corporate credit union. In determining whether or not to approve any paid-in capital instrument, NCUA will consider such features as maturity, capital amortization schedule, participation, voting, acceleration, redemption, or other rights of the holder, if any. NCUA will also consider the strategic purpose and financial impact of the proposed paid-in capital issuance and the corporate credit union's financial condition and management capabilities.

Non secured obligation means an obligation backed solely by the creditworthiness of the obligor.

Official means any director or committee member.

Paid-in capital means accounts or other interests of a corporate credit union that: Are available to cover losses that exceed reserves and undivided earnings; are not insured by the NCUSIF or other share or deposit insurers; and are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital after the funds are called. Paid-in capital includes both member paid-in capital and non member paid-in capital. In the event of liquidation of the corporate credit union, paid-in capital is payable only after satisfaction of all liabilities of the liquidation estate, including uninsured share obligations to shareholders, the NCUSIF, and membership capital holders. Paid-in capital shall not exceed reserves and undivided earnings.

Pair-off transaction means a security purchase transaction that is closed out or sold at, or prior to, the settlement or expiration date.

Prepayment model means an empirical method which produces a reasonable and supportable forecast of mortgage prepayments in alternative interest rate scenarios. Models are typically available from securities broker-dealers and industry-recognized information providers. These models are used in tests to forecast the weighted average life, change in weighted average life, and price sensitivity of CMOs/REMICs and mortgage-backed securities.

Real estate mortgage investment conduit (REMIC) means a nontaxable entity formed for the sole purpose of holding a fixed pool of mortgages secured by an interest in real property and issuing multiple classes of interests in the underlying mortgages.

Regular way settlement means delivery of a security from a seller to a buyer within the specified number of days established for that type of security.

Repurchase transaction means a transaction in which a corporate credit union agrees to purchase a security from a counterparty and to resell the same or any identical security to that counterparty at a later date.

Reserve ratio means the corporate credit union's reserves and undivided earnings plus paid in capital divided by its moving daily average net assets.

Reserves and undivided earnings means all forms of retained earnings, including regular or statutory reserves and all valuation allowances established to meet the full and fair disclosure requirements of § 702.3 of this chapter.

Residual interest means the remainder cash flows from a CMO or REMIC transaction after payments due bondholders and trust administrative expenses have been satisfied.

Section 107(8) institution means an institution described in Section 107(8) of the Federal Credit Union Act (12 U.S.C. 1757(8)).

Securities lending means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

Senior management employee means a chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer (controller).

Settlement date means the date originally agreed to by a corporate credit union and a counterparty for settlement of the purchase or sale of a security.

Short sale means the sale of a security not owned by the seller.

Short-term investment means, for the purpose of issue ratings, an investment that has an initial maturity, or expected maturity, of one year or less.

Small business related security means a security as defined in Section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53)), i.e., a security, rated in one of the four highest rating categories by a nationally recognized statistical rating organization, that represents ownership of one or more promissory notes or leases of personal property which evidence the obligation of a small business concern. It does not mean a security issued or guaranteed by the Small Business Administration.

Stripped mortgage-backed security means a security that represents either the principal or interest only portion of the cash flows of an underlying pool of mortgages.

Trade association means an association of organizations or persons formed to promote their common interests. For the purposes of § 704.14, the term includes entities owned or controlled directly or indirectly by such an association but does not include credit unions.

Trade date means the date a corporate credit union originally agrees, whether orally or in writing, to enter into the purchase or sale of a security.

Weighted average life means the weighted average time to principal repayment of a security based upon the proportional balances of the cash flows that make up the security.

When-issued trading means the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities.

Wholesale corporate credit union means a corporate credit union which primarily serves other corporate credit unions.

§ 704.3 Corporate credit union capital.

(a) *General.* A corporate credit union must develop and ensure implementation of written short- and long-term capital goals, objectives, and strategies which provide for the building of capital consistent with regulatory requirements, the maintenance of sufficient capital to support the risk exposures that may arise from current and projected activities, and the periodic review and reassessment of the capital position of the corporate credit union.

(b) *Capital ratio.* A corporate credit union will maintain a minimum capital ratio of 4 percent, except as otherwise provided in this part. A corporate credit union must calculate its capital ratio at least monthly.

(c) *Reserve transfers.* A corporate credit union's monthly reserve transfers are based upon the level of its reserve ratio. Where the reserve ratio is greater than or equal to 4 percent, the reserve transfer is optional. Where the reserve ratio is greater than or equal to 3 percent but less than 4 percent, the corporate credit union must transfer .10 percent of its moving daily average net assets.

Where the reserve ratio is less than 3 percent, the corporate credit union must transfer .15 percent of its moving daily average net assets. Reserve transfers must be calculated on a monthly basis and funded on at least a quarterly basis.

(d) *Individual capital ratio, reserve transfer requirement.* (1) When significant circumstances or events warrant, NCUA may require a different minimum capital ratio and/or reserve transfer level for an individual corporate credit union based on its circumstances. Factors that might warrant a different minimum capital ratio or reserve transfer level include, but are not limited to, for example:

(i) An expectation that the corporate credit union has or anticipates losses resulting in capital inadequacy;

(ii) Significant exposure exists, unsupported by adequate capital or risk management processes, due to credit, liquidity, market, fiduciary, operational, and similar types of risks;

(iii) A merger has been approved; or

(iv) An emergency exists because of a natural disaster.

(2) When NCUA determines that a different minimum capital ratio or reserve transfer level is necessary or appropriate for a particular corporate credit union, NCUA will notify the corporate credit union in writing of the proposed ratio or level and, if applicable, the date by which the ratio should be reached. NCUA also will provide an explanation of why the proposed ratio or level is considered necessary or appropriate for the corporate credit union.

(3)(i) The corporate credit union may respond to any or all of the items in the notice. The response must be in writing and delivered to NCUA within 30 calendar days after the date on which the corporate credit union received the notice. NCUA may shorten the time period when, in its opinion, the condition of the corporate credit union so requires, provided that the corporate credit union is informed promptly of the new time period, or with the consent of the corporate credit union. In its discretion, NCUA may extend the time period for good cause.

(ii) Failure to respond within 30 calendar days or such other time period as may be specified by NCUA shall constitute a waiver of any objections to any item in the notice. Failure to address any item in a response shall constitute a waiver of any objection to that item.

(iii) After the close of the corporate credit union's response period, NCUA will decide, based on a review of the corporate credit union's response and other information concerning the corporate credit union, whether a different minimum capital ratio or reserve transfer level should be established for the corporate credit union and, if so, the ratio or level and the date the requirement will become effective. The corporate credit union will be notified of the decision in writing. The notice will include an explanation of the decision, except for a decision not to establish a different minimum capital ratio or reserve transfer level for the corporate credit union.

(e) *Failure to maintain minimum capital ratio requirement.* When a corporate credit union's capital ratio falls below the minimum required by paragraphs (b) or (d) of this section, or Appendix B of this part, as applicable, operating management of the corporate credit union must notify its board of directors, supervisory committee, and NCUA within 10 calendar days.

(f) *Capital restoration plan.* (1) A corporate credit union must submit a plan to restore and maintain its capital ratio at the minimum requirement when either of the following conditions exist:

(i) The capital ratio falls below the minimum requirement and is not restored to the minimum requirement by the next month end; or

(ii) Regardless of whether the capital ratio is restored by the next month end, the capital ratio falls below the minimum requirement for three months in any 12-month period.

(2) The capital restoration plan must, at a minimum, include the following:

(i) Reasons why the capital ratio fell below the minimum requirement;

(ii) Descriptions of steps to be taken to restore the capital ratio to the minimum requirement within specific time frames;

(iii) Actions to be taken to maintain the capital ratio at the minimum required level and increase it thereafter;

(iv) Balance sheet and income projections, including assumptions, for the current calendar year and one additional calendar year; and

(v) Certification from the board of directors that it will follow the proposed plan if approved by NCUA.

(3) The capital restoration plan must be submitted to NCUA within 30 calendar days of the occurrence. NCUA will respond to the corporate credit union regarding the adequacy of the plan within 45 calendar days of its receipt.

(g) *Capital directive.* (1) If a corporate credit union fails to submit a capital restoration plan; or the plan submitted is not deemed adequate to either restore capital or restore capital within a reasonable time; or the credit union fails to implement its approved capital restoration plan, NCUA may issue a capital directive.

(2) A capital directive may order a corporate credit union to:

(i) Achieve adequate capitalization within a specified time frame by taking any action deemed necessary, including but not limited to the following:

(A) Increase the amount of capital to specific levels;

(B) Reduce dividends;

(C) Limit receipt of deposits to those made to existing accounts;

(D) Cease or limit issuance of new accounts or any or all classes of accounts;

(E) Cease or limit lending or making a particular type or category of loans;

(F) Cease or limit the purchase of specified investments;

(G) Limit operational expenditures to specified levels;

(H) Increase and maintain liquid assets at specified levels; and

(I) Restrict or suspend expanded authorities issued under Appendix B of this part.

(ii) Adhere to a previously submitted plan to achieve adequate capitalization.

(iii) Submit and adhere to a capital plan acceptable to NCUA describing the means and a time schedule by which the corporate credit union shall achieve adequate capitalization.

(iv) Meet with NCUA.

(v) Take a combination of these actions.

(3) Prior to issuing a capital directive, NCUA will notify a corporate credit union in writing of its intention to issue a capital directive.

(i) The notice will state:

(A) The reasons for the issuance of the directive; and

(B) The proposed content of the directive.

(ii) A corporate credit union must respond in writing within 30 calendar days of receipt of the notice stating that it either concurs or disagrees with the notice. If it disagrees with the notice, it must state the reasons why the directive should not be issued and/or propose alternative contents for the directive. The response should include all matters that the corporate credit union wishes to be considered. For good cause, including the following conditions, the response time may be shortened or lengthened:

(A) When the condition of the corporate requires, and the corporate credit union is notified of the shortened response period in the notice;

(B) With the consent of the corporate credit union; or

(C) When the corporate credit union already has advised NCUA that it cannot or will not achieve adequate capitalization.

(iii) Failure to respond within 30 calendar days, or another time period specified in the notice, shall constitute a waiver of any objections to the proposed directive.

(4) After the closing date of the corporate credit union's response period, or the receipt of the response, if earlier, NCUA shall consider the response and may seek additional information or clarification. Based on the information provided during the response period, NCUA will determine whether or not to issue a capital directive and, if issued, the form it should take.

(5) Upon issuance, a capital directive and a statement of the reasons for its issuance will be delivered to the corporate credit union. A directive is effective immediately upon receipt by the corporate credit union, or upon such later date as may be specified therein, and shall remain effective and enforceable until it is stayed, modified, or terminated by NCUA.

(6) A capital directive may be issued in addition to, or in lieu of, any other action authorized by law in response to a corporate credit union's failure to achieve or maintain the applicable minimum capital ratios.

(7) Upon a change in circumstances, a corporate credit union may request reconsideration of the terms of the directive. Requests that are not based on a significant change in circumstances or are repetitive or frivolous will not be considered. Pending a decision on reconsideration, the directive shall continue in full force and effect.

§ 704.4 Board responsibilities.

(a) *General.* A corporate credit union's board of directors must approve comprehensive written strategic plans and operating policies, review them annually, and provide them upon request

to the auditors, supervisory committee, and NCUA.

(b) *Operating policies.* A corporate credit union's operating policies must be commensurate with the scope and complexity of the corporate credit union.

(c) *Procedures.* The board of directors of a corporate credit union must ensure that:

(1) Senior managers have an in-depth, working knowledge of their direct areas of responsibility and are capable of identifying, hiring, and retaining qualified staff;

(2) Qualified personnel are employed or under contract for all line support and audit areas, and designated back-up personnel or resources with adequate cross-training are in place;

(3) GAAP is followed, except where law or regulation has provided for a departure from GAAP;

(4) Accurate balance sheets, income statements, and internal risk assessments (*e.g.*, risk management measures of liquidity, market, and credit risk associated with current activities) are produced timely in accordance with §§ 704.6, 704.8, and 704.9;

(5) Systems are audited periodically in accordance with industry-established standards;

(6) Financial performance is evaluated to ensure that the objectives of the corporate credit union and the responsibilities of management are met; and

(7) Planning addresses the retention of external consultants, as appropriate, to review the adequacy of technical, human, and financial resources dedicated to support major risk areas.

§ 704.5 Investments.

(a) *Policies.* A corporate credit union must operate according to an investment policy that is consistent with its other risk management policies, including, but not limited to, those related to credit risk management, asset and liability management, and liquidity management. The policy must address, at a minimum:

(1) Appropriate tests and criteria, if any, for evaluating standard investments and investment transactions prior to purchase; and

(2) Risk analysis requirements for any new investment type or transaction, not previously owned or marketed by the corporate credit union, considered for purchase by the corporate credit union and/or for sale to members.

(b) *General.* All investments must be U.S. dollar-denominated and subject to the credit policy restrictions set forth in § 704.6.

(c) *Authorized activities.* A corporate credit union may invest in:

(1) Securities, deposits, and obligations set forth in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act, 12 U.S.C. 1757(7), 1757(8), and 1757(15), except as provided in this section;

(2) Deposits in, the sale of federal funds to, and debt obligations of corporate credit unions, Section 107(8) institutions, and state banks, trust companies, and mutual savings banks not domiciled in the state in which the corporate credit union does business;

(3) Corporate CUSOs, as defined in and subject to the limitations of § 704.11;

(4) Marketable debt obligations of corporations chartered in the United States. This authority does not apply to debt obligations that are convertible into the stock of the corporation;

(5) Asset-backed securities; and

(6) CMOs/REMICs that meet the Federal Financial Institutions Examination Council High Risk Security Test (HRST) requirements.

(i) The HRST must be prepared quarterly on all CMOs/REMICs, documented and reviewed by an appropriate committee, and retained while the instrument is held in portfolio and until completion of the next audit and NCUA examination.

(ii) A corporate credit union's board of directors must approve at least three prepayment models for CMOs/REMICs unless a median estimate from an industry-recognized information provider is used. These approved models must be used consistently for all subsequent compliance tests. Any changes in approved models should be infrequent and documented with a reasonable and supportable justification.

(iii) A corporate credit union must obtain prepayment estimates, based upon an instantaneous, permanent, parallel shift in market rates of plus or minus 100, 200, and 300 basis points, to conduct the HRST.

(A) If a median prepayment estimate is used, it must be obtained from an industry-recognized information provider. At purchase, the median estimate must be based on at least 5 prepayment models. At retesting, the median estimate must be based on at least 2 prepayment models.

(B) If individual prepayment models are used, estimates must be obtained from all of the models identified in the corporate credit union's investment policy. One of the individual prepayment models may be the median prepayment estimate from an industry-recognized information provider. All of the models identified in the investment policy must be used when purchasing and retesting a CMO/REMIC. At purchase, a CMO/REMIC must pass the tests for each prepayment model used. At retesting, the CMO/REMIC must pass the tests for a majority of the prepayment models used at the time of purchase.

(d) *Repurchase agreements.* A corporate credit union may enter into a repurchase agreement provided that:

(1) The corporate credit union, or its agent, nominee, or designee, receives written confirmation of the transaction and either takes physical possession or control of the repurchase securities or is recorded as owner of the repurchase securities through the Federal Reserve Book-Entry Securities Transfer System;

(2) The repurchase securities are legal investments for that corporate credit union;

(3) In the event of default, the corporate credit union sells the repurchase securities in a timely manner, subject to a bankruptcy stay, to satisfy the commitment of any net principal and interest owed to it by the counterparty;

(4) The corporate credit union receives daily assessment of the market value of the repurchase securities, including a market quote or dealer bid indication and any accrued interest, and maintains adequate margin that reflects a risk assessment of the repurchase securities and the term of the transaction;

(5) The corporate credit union has entered into signed contracts with all approved counterparties. Such contracts must address any supplemental terms and conditions necessary to meet the specific requirements of this part. Third party arrangements must be supported by tri-party contracts in which the repurchase securities are priced and reported daily and the tri-party agent ensures compliance; and

(6) The corporate credit union has sufficient market relationships established in advance to timely execute the disposition of the repurchase securities.

(e) *Securities Lending.* A corporate credit union may enter into a securities lending transaction provided that:

(1) The corporate credit union, or its agent, nominee, or designee, receives written confirmation of the loan, obtains a perfected first priority security interest in the collateral, and either takes physical possession or control of the collateral or is recorded as owner of the collateral through the Federal Reserve Book-Entry Securities Transfer System;

(2) The collateral is a legal investment for that corporate credit union;

(3) The corporate credit union, directly or through its agent, receives daily assessment of the market value of collateral, including a market quote or dealer bid indication and any accrued interest, and maintains adequate margin that reflects a risk assessment of the collateral and terms of the loan; and

(4) The corporate credit union, directly or through its agent, has executed a written loan and security agreement with the borrower, approved any form of agreement attached thereto, and obtained the right to approve any material modification to such agreement.

(f) *Investment companies.* A corporate credit union may invest in an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a), provided that the portfolio of such investment company is restricted by its investment policy solely to investments and investment transactions that are permissible for that corporate credit union.

(g) *Forward settlement of transactions later than regular way.* A corporate credit union may enter into an agreement to purchase or sell an instrument, with settlement later than regular way, provided that:

(1) Delivery and acceptance are mandatory;

(2) The transaction is clearly disclosed in the appropriate risk reporting required under § 704.8(b);

(3) If the corporate credit union is the purchaser, it has adequate cash flow projections evidencing its ability to purchase the instrument;

(4) If the corporate credit union is the seller, it owns the instrument on the trade date; and

(5) The transaction is settled on a cash basis at the settlement date.

(h) *Prohibitions.* A corporate credit union is prohibited from:

(1) Purchasing or selling off balance sheet financial derivatives, such as futures, options, interest rate swaps, or forward rate agreements;

(2) Engaging in pair-off transactions, when-issued trading, adjusted trading, or short sales; and

(3) Purchasing stripped mortgage-backed securities, residual interests in CMO/REMICs, mortgage servicing rights, commercial mortgage related securities, or small business related securities.

(i) *Conflicts of interest.* A corporate credit union's officials, employees, and immediate family members of such individuals, may not receive pecuniary consideration in connection with the making of an investment or deposit by the corporate credit union. Employee compensation is exempt from this prohibition. All transactions not specifically prohibited by this paragraph must be conducted at arm's length and in the interest of the corporate credit union.

(j) *Grandfathering.* A corporate credit union's authority to hold an investment is governed by the regulation in effect at the time of purchase. However, all grandfathered investments are subject to the requirements of §§ 704.8 and 704.9.

§ 704.6 Credit risk management.

(a) *Policies.* A corporate credit union must operate according to a credit risk management policy that is commensurate with the investment and lending risks and activities it undertakes. The policy must address, at a minimum:

(1) The approval process associated with credit limits;

(2) Due diligence analysis requirements;

(3) Maximum credit limits with each obligor and transaction counterparty, set as a percentage of the sum of reserves and undivided earnings and paid-in capital. In addition to addressing loans, deposits, and securities, limits with transaction counterparties must address aggregate exposures of all transactions, including, but not necessarily limited to, repurchase agreements, securities lending, and forward settlement of purchases or sales of investments; and

(4) Concentrations of credit risk (*e.g.*, industry type, sector type, and geographic).

(b) *Exemption.* The requirements of this section do not apply to instruments that are issued or fully guaranteed as to principal and interest by the U.S. government or its agencies or enterprises or are fully insured (including accumulated interest) by the National Credit Union Administration or Federal Deposit Insurance Corporation.

(c) *Concentration limits.* (1) Aggregate investments in mortgage-backed and asset-backed securities are limited to 200 percent of the sum of reserves and undivided earnings and paid-in capital for any single security or trust.

(2) Except for investments in a wholesale corporate credit union, aggregate investments in repurchase and securities lending agreements with any one counterparty are limited to 400 percent of the sum of reserves and undivided earnings and paid-in capital.

(3) Except for investments in a wholesale corporate credit union, the aggregate of all investments in non secured obligations of any single domestic issuer is limited to 100 percent of the sum of reserves and undivided earnings and paid-in capital.

(4) For purposes of measurement, each new credit transaction must be evaluated in terms of the corporate credit union's sum of reserves and undivided earnings and paid-in capital at the time of the transaction. A subsequent reduction in the sum of reserves and undivided earnings and paid-in capital will require a suspension of additional transactions until maturities, sales or terminations bring existing exposures within the requirements of this part.

(d) *Credit ratings.* (1) All debt instruments must have a credit rating from at least one nationally recognized statistical rating organization (NRSRO).

(2) The rating(s) must be monitored for as long as the corporate owns an instrument.

(3) At the time of purchase, asset-backed securities must be rated no lower than AAA (or equivalent), other long-term investments must be rated no lower than AA (or equivalent), and short-term investments must be rated no lower than A–1 (or equivalent).

(4) Any rated instrument that is downgraded by the NRSRO used to meet the requirements of this part at the time of purchase must be reviewed by the board or an appropriate committee within 30 calendar days of the downgrade. Instruments that fall below the minimum rating requirements of this part are subject to the requirements of § 704.10.

(e) *Reporting and documentation.* (1) A written evaluation of each credit line must be prepared at least annually and formally approved by the board or an appropriate committee. At least monthly, the board or an appropriate committee must receive a watch list of existing and/or potential credit problems and summary credit exposure

reports, which demonstrate compliance with the corporate credit union's risk management policies.

(2) At a minimum, the corporate credit union must maintain:

(i) A justification for each approved credit line;

(ii) Disclosure documents, if any, for all instruments held in portfolio. Documents for an instrument that has been sold must be retained until completion of the next NCUA examination; and

(iii) The latest available financial reports, industry analyses, internal and external analyst evaluations, and rating agency information sufficient to support each approved credit line.

§ 704.7 Lending.

(a) *Policies.* A corporate credit union must operate according to a lending policy which addresses, at a minimum:

(1) Loan types and limits;

(2) Required documentation and collateral; and

(3) Analysis and monitoring standards.

(b) *General.* Each loan or line of credit limit will be determined after analyzing the financial and operational soundness of the borrower and the ability of the borrower to repay the loan.

(c) *Loans to member credit unions.* (1) The maximum aggregate amount in unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall not exceed 50 percent of capital or 75 percent of the sum of reserves and undivided earnings and paid-in capital, whichever is greater.

(2) The maximum aggregate amount in secured loans and irrevocable lines of credit to any one member credit union, excluding those secured by shares or marketable securities and member reverse repurchase transactions, shall not exceed 100 percent of capital or 200 percent of the sum of reserves and undivided earnings and paid-in capital, whichever is greater.

(d) *Loans to members that are not credit unions.* Any loan or irrevocable line of credit made to a member, other than a credit union or a corporate CUSO, must be made in compliance with § 701.21(h) of this chapter, governing member business loans, unless such loan or line of credit is fully guaranteed by a credit union. The aggregate amount of loans and irrevocable lines of credit to members other than credit unions and corporate CUSOs shall not exceed 15 percent of the corporate credit union's capital plus pledged shares.

(e) *Loans to non member credit unions.* A loan to a credit union that is not a member of the corporate credit union, other than through a loan participation with another corporate credit union, is only permissible if the loan is for an overdraft related to the providing of correspondent services pursuant to § 704.12. Generally, such a loan will have a maturity of only one business day.

(f) *Loans to corporate CUSOs.* A corporate credit union may make loans and issue lines of credit to corporate CUSOs, subject to the limitations of § 704.11.

(g) *Participation loans with other corporate credit unions.* A corporate credit union is permitted to participate in a loan with another corporate credit union and must retain an interest of at least 5 percent of the face amount of the loan. The participation agreement may be executed at any time prior to, during, or after disbursement. A participating corporate credit union must exercise the same due diligence as if it were the originating corporate credit union.

(h) *Prepayment penalties.* If provided for in the loan contract, a corporate credit union is authorized to assess prepayment penalties on loans.

§ 704.8 Asset and liability management.

(a) *Policies.* A corporate credit union must operate according to a written asset and liability management policy which addresses, at a minimum:

(1) The purpose and objectives of the corporate credit union's asset and liability activities;

(2) The tests that will be used to evaluate instruments prior to purchase;

(3) The maximum allowable percentage decline in net economic value (NEV), compared to current NEV;

(4) The minimum allowable NEV ratio;

(5) The maximum decline in net income (before reserve transfers), in percentage and dollar terms, compared to current net income;

(6) Policy limits and specific test parameters for the interest rate risk simulation tests set forth in paragraph (d) of this section; and

(7) The modeling of indexes that serve as references in financial instrument coupon formulas.

(b) *Asset and liability management committee (ALCO).* A corporate credit union's ALCO must

have at least one member who is also a member of the board of directors. The ALCO must review asset and liability management reports on at least a monthly basis. These reports must address compliance with Federal Credit Union Act, NCUA Rules and Regulations (12 CFR chapter VII), and all related risk management policies.

(c) *Penalty for early withdrawals.* A corporate credit union that permits early certificate/share withdrawals must assess market-based penalties sufficient to cover the estimated replacement cost of the certificate/share redeemed.

(d) *Interest rate sensitivity analysis.* (1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the Treasury yield curve of plus and minus 100, 200, and 300 basis points on its NEV, NEV ratio, and net interest income. If the base case NEV ratio falls below 2 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 2 percent;

(ii) Limit its risk exposure to levels that do not result in an NEV ratio below 1 percent; and

(iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 18 percent, except as provided in paragraph (e) of this section.

(2) A corporate credit union that owns an aggregate amount of instruments which possess unmatched embedded options in a book value amount which exceeds 200 percent of the sum of its reserves and undivided earnings and paid-in capital must conduct periodically, as appropriate, additional tests that address market factors which potentially can impact the value of the instruments and that reflect the policy limits addressed in paragraph (a) of this section. These factors should include, but not be limited to, the following:

(i) Changes in the shape of the Treasury yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds;

(iii) Adjustments to the market spread assumptions for non Treasury instruments to consider the impact of widening spreads; and

(iv) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

(e) *Base-plus.* (1) In performing the rate stress tests set forth in paragraph (d)(1)(i) of this section, the NEV of a corporate credit union which has met the requirements of this paragraph (e) may decline as much as 25 percent.

(2) The corporate credit union must meet additional management and infrastructure requirements and receive NCUA's written approval. The additional requirements are set forth in the NCUA publication Guidelines for Submission of Requests for Expanded Authority. The procedures for processing base-plus authority are the same as those set forth in Appendix B of this part for requesting expanded authorities.

(3) The corporate credit union must evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in paragraph (d)(1)(i) of this section.

(4) Regardless of the amount of instruments which possess unmatched embedded options, the corporate credit union must conduct periodically, as appropriate, the tests set forth in paragraph (d)(2) of this section.

(f) *Regulatory violations.* If a corporate credit union's base case NEV or NEV ratio or the NEV or NEV ratio resulting from the tests indicated in paragraph (d)(1)(i) of this section decline below the limits established by this part and are not brought into compliance within 10 calendar days, operating management of the corporate credit union must immediately report the information to the board of directors, supervisory committee, and NCUA. If any of these measures remain below the limits established by this part within 30 calendar days of the violation, the corporate credit union must submit a detailed, written action plan to NCUA that sets forth the time needed and means by which it intends to correct the violation. If NCUA determines that the plan is unacceptable, the corporate credit union must immediately restructure the balance sheet to bring the exposures back within compliance or adhere to an alternative course of action determined by NCUA.

(g) *Policy violations.* If a corporate credit union's NEV or NEV ratio for any required test(s) exceed the limits established by the board, it must determine how it will bring the exposures within policy limits. The disclosure to the board of the limit violation must occur no later than its next regularly scheduled board meeting.

§ 704.9 Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

(1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;

(2) Regularly monitor sources of internal and external liquidity;

(3) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and

(4) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:

(i) List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;

(ii) Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and

(iii) Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b) *Borrowing.* A corporate credit union may borrow up to 10 times capital or 50 percent of shares (excluding shares created by the use of member reverse repurchase agreements) and capital, whichever is greater. CLF borrowings and borrowed funds created by the use of member reverse repurchase agreements are excluded from this limit. The corporate credit union must demonstrate that sufficient contingent sources of liquidity remain available.

§ 704.10 Divestiture.

(a) Any corporate credit union in possession of an investment that fails to meet a requirement of this part must, within 30 calendar days of the failure, report the failed investment to its board of directors, supervisory committee, and NCUA. If the corporate credit union does not sell the failed investment, and the investment continues to fail to meet a requirement of this part, the corporate credit union must, within 30 calendar days of the failure, provide to NCUA a written action plan that addresses:

(1) The investment's characteristics and risks;

(2) The process to obtain and adequately evaluate the investment's market pricing, cash flows, and risk;

(3) How the investment fits into the credit union's asset and liability management strategy;

(4) The impact that either holding or selling the investment will have on the corporate credit union's earnings, liquidity, and capital in different interest rate environments; and

(5) The likelihood that the investment may again pass the requirements of this part.

(b) NCUA may require, for safety and soundness reasons, a shorter time period for plan development than that set forth in paragraph (a) of this section.

(c) If the plan described in paragraph (a) of this section is not approved by NCUA, the credit union must adhere to NCUA's directed course of action.

§ 704.11 Corporate Credit Union Service Organizations (Corporate CUSOs).

(a) A corporate CUSO is an entity that:

(1) Is at least partly owned by a corporate credit union;

(2) Primarily serves credit unions;

(3) Restricts its services to those related to the normal course of business of credit unions; and

(4) Is structured as a corporation, limited liability company, or limited partnership under state law.

(b) The aggregate of all investments in and loans to member and non member corporate CUSOs shall not exceed 15 percent of a corporate credit union's capital. However, a corporate credit union may loan to member and non member corporate CUSOs an additional 15 percent of capital if collateralized by assets in which the corporate credit union has perfected a security interest under state law. A corporate credit union may not use this authority to acquire control, directly or indirectly, of another financial institution, or to invest in shares, stocks, or obligations of another financial institution, insurance company, trade association, liquidity facility, or similar organization. A corporate CUSO must be operated as an entity separate from any credit union. A corporate credit union investing in or lending to a corporate CUSO must obtain a written legal opinion that

the corporate CUSO is organized and operated in such a manner that the corporate credit union will not reasonably be held liable for the obligations of the corporate CUSO. This opinion must address factors that have led courts to "pierce the corporate veil," such as inadequate capitalization, lack of separate corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records.

(c) An official of a corporate credit union which has invested in or loaned to a corporate CUSO may not receive, either directly or indirectly, any salary, commission, investment income, or other income, compensation, or consideration from the corporate CUSO. This prohibition also extends to immediate family members of officials.

(d) Prior to making an investment in or loan to a corporate CUSO, a corporate credit union must obtain a written agreement that the corporate CUSO will:

(1) Follow GAAP;

(2) Provide financial statements to the corporate credit union at least quarterly;

(3) Obtain an annual CPA opinion audit and provide a copy to the corporate credit union; and

(4) Allow the auditor, board of directors, and NCUA complete access to its books, records, and any other pertinent documentation.

(e) Corporate credit union authority to invest in or loan to a CUSO is limited to that provided in this section. A corporate credit union is not authorized to invest in or loan to a CUSO under § 701.27 of this chapter.

§ 704.12 Services.

Except for correspondent services to a non member, natural person credit union branch office operating in the geographic area defined in the corporate credit union's charter, a corporate credit union may provide services only to its members, subject to the limitations of this part. A corporate credit union may not provide services to non members through agreements with other corporate credit unions or pursuant to § 701.26 of this chapter, except with the written permission of NCUA.

§ 704.13 Fixed assets.

(a) A corporate credit union's ownership in fixed assets shall be limited as described in § 701.36 of this chapter, except that in lieu of § 701.36(c)(1) through (4) of this chapter, paragraph (b) of this section applies.

(b) A corporate credit union may invest in fixed assets where the aggregate of all such investments does not exceed 15 percent of the corporate credit union's capital. A corporate credit union desiring to exceed the limitation shall submit a written request to NCUA. Requests shall be supplemented by such statements and reports as NCUA may require. If the corporate credit union does not receive notification of the action taken on its request within 45 calendar days of the date all required information has been received, it may proceed with its proposed investment in fixed assets.

§ 704.14 Representation.

(a) *Board representation.* The board shall be determined as stipulated in the standard corporate federal credit union bylaws governing election procedures, provided that:

(1) At least a majority of directors, including the chair of the board, must serve on the board as representatives of member credit unions;

(2) The chair of the board may not serve simultaneously as an officer, director, or employee of a credit union trade association;

(3) A majority of directors may not serve simultaneously as officers, directors, or employees of the same credit union trade association or its affiliates (not including chapters or other subunits of a state trade association);

(4) For purposes of meeting the requirements of paragraphs (a)(2) and (a)(3) of this section, an individual may not serve as a director or chair of the board if that individual holds a subordinate employment relationship to another employee who serves as an officer, director, or employee of a credit union trade association; and

(5) In the case of a corporate credit union whose membership is composed of more than 25 percent non credit unions, the majority of directors serving as representatives of member credit unions, including the chair, must be elected only by member credit unions.

(b) *Representatives of organizational members.* (1) An organizational member of a corporate credit union is a member that is not a natural person. An organizational member may appoint one of its members or officials as a representative to the corporate credit union. The representative shall be empowered to attend membership meetings,

to vote, and to stand for election on behalf of the member. No individual may serve as the representative of more than one organizational member in the same corporate credit union.

(2) Any vacancy on the board of a corporate credit union caused by a representative being unable to complete his or her term shall be filled by the board of the corporate credit union according to its bylaws governing the filling of board vacancies.

(c) *Recusal provision.* (1) No director, committee member, officer, or employee of a corporate credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his or her pecuniary interest or the pecuniary interest of any entity (other than the corporate credit union) in which he or she is interested, except if the matter involves general policy applicable to all members, such as setting dividend or loan rates or fees for services.

(2) An individual is "interested" in an entity if he or she:

(i) Serves as a director, officer, or employee of the entity;

(ii) Has a business, ownership, or deposit relationship with the entity; or

(iii) Has a business, financial, or familial relationship with an individual whom he or she knows has a pecuniary interest in the entity.

(3) In the event of the disqualification of any directors, by operation of paragraph (c)(1) of this section, the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified directors, may exercise, by majority vote, all the powers of the board with respect to the matter under consideration. Where all of the directors are disqualified, the matter must be decided by the members of the corporate credit union.

(4) In the event of the disqualification of any committee member by operation of paragraph (c)(1) of this section, the remaining qualified committee members, if constituting a quorum with the disqualified committee members, may exercise, by majority vote, all the powers of the committee with respect to the matter under consideration. Where all of the committee members are disqualified, the matter shall be decided by the board of directors.

(d) *Administration.* (1) A corporate credit union shall be under the direction and control of its board of directors. While the board may delegate the performance of administrative duties, the board is not relieved of its responsibility for their performance. The board may employ a chief executive officer who shall have such authority and such powers as delegated by the board to conduct business from day to day. Such chief executive officer must answer solely to the board of the corporate credit union, and may not be an employee of a credit union trade association.

(2) The provisions of § 701.14 of this chapter apply to corporate credit unions, except that where "Regional Director" is used, read "NCUA Board."

§ 704.15 Audit requirements.

(a) *External audit.* The corporate credit union supervisory committee shall cause an annual opinion audit of the financial statements to be made. The audit must be performed in accordance with generally accepted auditing standards and the audited financial statements must be prepared consistent with GAAP, except where law or regulation has provided for a departure from GAAP. The supervisory committee shall submit the audit report to the board of directors. A copy of the audit report, and copies of all communications that are provided to the corporate credit union by the external auditor, shall be submitted to NCUA within 30 calendar days after receipt by the board of directors. If requested by NCUA, the external auditor's workpapers shall be made available, at the auditor's office or elsewhere, for NCUA's review. The corporate credit union shall submit a summary of the audit report to the membership at the next annual meeting.

(b) *Internal audit.* A corporate credit union with average daily assets in excess of $400 million for the preceding calendar year, or as ordered by NCUA, must employ or contract, on a full- or part-time basis, the services of an internal auditor. The internal auditor's responsibilities will, at a minimum, comply with the Standards and Professional Practices of Internal Auditing, as established by the Institute of Internal Auditors. The internal auditor will report directly to the chair of the corporate credit union's supervisory committee, who may delegate supervision of the internal auditor's daily activities to the chief executive officer of the corporate credit union. The internal auditor's reports, findings, and recommendations will be in writing and presented to the supervisory commit-

tee no less than quarterly, and will be provided upon request to the external auditor and NCUA.

§ 704.16 Contracts/written agreements.

Services, facilities, personnel, or equipment shared with any party shall be supported by a written contract, with the duties and responsibilities of each party specified and the allocation of service fee/expenses fully supported and documented.

§ 704.17 State-chartered corporate credit unions.

(a) This part does not expand the powers and authorities of any state-chartered corporate credit union, beyond those powers and authorities provided under the laws of the state in which it was chartered.

(b) A state-chartered corporate credit union that is not insured by the NCUSIF, but that receives funds from federally insured credit unions, is considered an "institution-affiliated party" within the meaning of Section 206(r) of the Federal Credit Union Act, 12 U.S.C. 1786(r).

(c) NCUA will notify, consult with, and provide explanation to the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union.

§ 704.18 Fidelity bond coverage.

(a) *Scope.* This section provides the fidelity bond requirements for employees and officials in corporate credit unions.

(b) *Review of coverage.* The board of directors of each corporate credit union shall, at least annually, carefully review the bond coverage in force to determine its adequacy in relation to risk exposure and to the minimum requirements in this section.

(c) *Minimum coverage; approved forms.* Every corporate credit union will maintain bond coverage with a company holding a certificate of authority from the Secretary of the Treasury. All bond forms, and any riders and endorsements which limit the coverage provided by approved bond forms, must receive the prior written approval of NCUA. Fidelity bonds must provide coverage for the fraud and dishonesty of all employees, directors, officers, and supervisory and credit committee members. Notwithstanding the foregoing, all bonds must include a provision, in a form approved by NCUA, requiring written notification by surety to NCUA:

(1) When the bond of a credit union is terminated in its entirety;

(2) When bond coverage is terminated, by issuance of a written notice, on an employee, director, officer, supervisory or credit committee member; or

(3) When a deductible is increased above permissible limits. Said notification shall be sent to NCUA and shall include a brief statement of cause for termination or increase.

(d) *Minimum coverage amounts.* (1) The minimum amount of bond coverage will be computed based on the corporate credit union's daily average net assets for the preceding calendar year. The following table lists the minimum requirements:

Daily average net assets	Minimum bond (million)
Less than $50 million	$1.0
$50–$99 million	2.0
$100–$499 million	4.0
$500–$999 million	6.0
$1.0–$1.999 billion	8.0
$2.0–$4.999 billion	10.0
$5.0–$9.999 billion	15.0
$10.0–$24.999 billion	20.0
$25.0 billion plus	25.0

(2) It is the duty of the board of directors of each corporate credit union to provide adequate protection to meet its unique circumstances by obtaining, when necessary, bond coverage in excess of the minimums in the table in paragraph (d)(1) of this section.

(e) *Deductibles.* (1) The maximum amount of deductibles allowed are based on the corporate credit union's reserve ratio. The following table sets out the maximum deductibles, except that in each category the maximum deductible shall be $5 million:

Reserve ratio	Maximum deductible
Less than 1.0 percent	7.5 percent of the sum of reserves and undivided earnings and paid-in capital.
1.0–1.74 percent	10.0 percent of the sum of reserves and undivided earnings and paid-in capital
1.75–2.24 percent	12.0 percent of the sum of reserves and undivided earnings and paid-in capital.
Greater than 2.25 percent	15.0 percent of the sum of reserves and undivided earnings and paid-in capital.

(2) A deductible may be applied separately to one or more insuring clauses in a blanket bond. Deductibles in excess of those showing in this section must have the written approval of NCUA at least 30 calendar days prior to the effective date of the deductibles.

(f) *Additional coverage.* NCUA may require additional coverage for any corporate credit union when, in the opinion of NCUA, current coverage is insufficient. The board of directors of the corporate credit union must obtain additional coverage within 30 calendar days after the date of written notice from NCUA.

§ 704.19 Wholesale corporate credit unions.

(a) *General.* Wholesale corporate credit unions are subject to the preceding requirements of this part, except as set forth in this section.

(b) *Capital.* (1) A wholesale corporate credit union will maintain a minimum capital ratio of 5 percent.

(2) A wholesale corporate credit union shall make reserve transfers at the lower of .10 percent of its moving daily average net assets or the amount that would be required under § 704.3(c).

(i) Required transfers are to be made from earnings in either the prior calendar month or prior twelve-month period. Transfers made during the prior twelve-month period must be greater than or equal to the aggregate amount of required reserve transfers for each of the months in that twelve-month period.

(ii) NCUA and, in the case of state-chartered wholesale corporate credit unions, the state supervisory authority, must be notified within 30 calendar days of the close of any calendar month in which a wholesale corporate credit union's required reserve transfer exceeds earnings for that month. The notice must include the dollar amounts of the required reserve transfer and earnings for that month and for the prior twelve-month period. The notice must also provide an explanation of why the current month's required reserve transfer exceeded earnings for that month.

(c) *Asset and liability management.* (1) In conducting the interest rate sensitivity analysis set forth in § 704.8(d)(1)(i), a wholesale corporate credit union must limit its risk exposure to levels that do not result, at any time, in an NEV ratio below .75 percent or a decline in NEV of more than 35 percent.

(2) A wholesale corporate credit union must obtain, at its expense, an annual third-party review of its asset and liability management modeling system.

Appendix A to Part 704—Model Forms

This appendix contains sample forms intended for use by corporate credit unions to aid in compliance with the membership capital account and paid-in capital disclosure requirements of § 704.2. Corporate credit unions that use this form will be in compliance with those requirements.

Sample Form 1

Terms and Conditions of Membership Capital Account

(1) A membership capital account is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) A member credit union may withdraw membership capital with three years' notice.

(3) Membership capital cannot be used to pledge borrowings.

(4) Membership capital is available to cover losses that exceed reserves and undivided earnings and paid-in capital.

(5) Where the corporate credit union is liquidated, membership capital accounts are payable only after satisfaction of all liabilities of the liquidation estate including uninsured obligations to shareholders and the NCUSIF.

If the form is used when an account is opened, it must also contain the following statement:

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the membership capital account.

The form must be signed by either all of the directors of the member credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

If the form is used for the annual notice requirement, it must be signed by the chair of the corporate credit union. The chair must then sign a statement which certifies that the form has been sent to member credit unions with membership capital accounts. The certification must be main-

tained in the corporate credit union's files and be available for examiner review.

Sample Form 2

Terms and Conditions of Paid-In Capital

(1) Paid-in capital is not subject to share insurance coverage by the NCUSIF or other deposit insurer.

(2) The funds are callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital after the funds are called.

(3) Paid-in capital is available to cover losses that exceed reserves and undivided earnings.

(4) Paid-in capital is subordinate to membership capital and the NCUSIF.

If the form is used when a paid-in capital instrument is created, it must also contain the following statement:

I have read the above terms and conditions and I understand them. I further agree to maintain in the credit union's files the annual notice of terms and conditions of the paid-in capital instrument.

The form must be signed by either all of the directors of the credit union or, if authorized by board resolution, the chair and secretary of the board of the credit union.

If the form is used for the annual notice requirement, it must be signed by the chair of the corporate credit union. The chair must then sign a statement which certifies that the form has been sent to credit unions with paid-in capital accounts. The certification must be maintained in the corporate credit union's files and be available for examiner review.

Appendix B to Part 704—Expanded Authorities and Requirements

A corporate credit union may obtain expanded authorities if it meets all of the requirements of this part 704, fulfills additional capital, management, infrastructure, and asset and liability requirements, and receives NCUA's written approval. The additional requirements and authorities are set forth in this Appendix and in the NCUA publication Guidelines for Submission of Requests for Expanded Authority. A corporate credit union which seeks expanded authorities must submit to NCUA a self-assessment plan which analyzes and supports its request. A corporate credit union may adopt expanded authorities when NCUA has provided final approval. If NCUA denies a request for expanded authorities, it will advise the corporate of the reasons for the denial and what it must do to resubmit its request. NCUA may revoke these expanded authorities at any time if an analysis indicates a significant deficiency. NCUA will notify the corporate credit union in writing of the identified deficiency. A corporate credit union may request, in writing, reinstatement of the revoked authorities by providing a self-assessment plan which details how it has corrected these deficiencies.

(a) In order to participate in the authorities set forth in paragraphs (b) through (d) of this Part I, a corporate credit union must:

(1) Have a minimum capital ratio of 5 percent;

(2) Evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in § 704.8(d)(1)(i); and

(3) Regardless of the amount of instruments which possess unmatched embedded options, conduct periodically, as appropriate, the tests set forth in § 704.8(d)(2).

(b) A corporate credit union which has met the requirements of paragraph (a) of this Part I is not bound by the concentration limits on investments set forth at § 704.6(c)(1) and (2). Instead, the corporate credit union must establish limits on such investments as a percentage of the sum of reserves and undivided earnings and paid-in capital that take into account the relative amount of credit risk exposure based upon, but not limited to, the legal and financial structure of the transaction, the collateral, all other types of credit enhancement, and the term of the transaction.

(c) A corporate credit union which has met the requirements of paragraph (a) of this Part I may:

(1) Except for investments in a wholesale corporate credit union, invest in non secured obligations of any single domestic issuer up to 150 percent of the sum of reserves and undivided earnings and paid-in capital;

(2) Purchase long-term investments rated no lower than AA-(or equivalent);

(3) Purchase asset-backed securities rated no lower than AA (or equivalent);

(4) Engage in short sales of permissible investments to reduce interest rate risk;

(5) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk;

(6) Purchase CMOs/REMICs using fewer prepayment models than required in § 704.5(c)(6);

(7) Enter into a repurchase transaction where the collateral securities are rated no lower than A (or equivalent);

(8) Enter into a dollar roll transaction; and

(9) Engage in when-issued trading, when accounted for on a trade date basis.

(d) In performing the rate stress tests set forth in § 704.8(d)(1)(i), the NEV of a corporate credit union which has met the requirements of paragraph (a) of this Part I may decline as much as 35 percent.

(e) The maximum aggregate amount in unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall not exceed 100 percent of the corporate credit union's capital. The board of directors will establish the limit, as a percent of the corporate credit union's capital plus pledged shares, for secured loans and irrevocable lines of credit.

Part II

(a) In order to participate in the authorities set forth in paragraphs (b)–(d) of this Part II, a corporate credit union must:

(1) Have a minimum capital ratio of 6 percent; and

(2) Evaluate monthly the changes in NEV, NEV ratio, and net interest income for the tests set forth in § 704.8(d)(1)(i); and

(3) Regardless of the amount of instruments which possess unmatched embedded options, conduct periodically, as appropriate, the tests set forth in § 704.8(d)(2).

(b) A corporate credit union which has met the requirements of paragraph (a) of this Part II is not bound by the concentration limits on investments set forth at § 704.6(c) (1) and (2). Instead, the corporate credit union must establish limits on such investments as a percentage of the sum of reserves and undivided earnings and paid-in capital, that take into account the relative amount of credit risk exposure based upon, but not limited to, the legal and financial structure of the transaction, the collateral, all other types of credit enhancement, and the term of the transaction.

(c) A corporate credit union which has met the requirements of paragraph (a) of this Part II may:

(1) Except for investments in a wholesale corporate credit union, invest in nonsecured obligations of any single domestic issuer up to 250 percent of the sum of reserves and undivided earnings and paid-in capital;

(2) Purchase long-term investments rated no lower than A· (or equivalent);

(3) Purchase asset-backed securities rated no lower than AA (or equivalent);

(4) Engage in short sales of permissible investments to reduce interest rate risk;

(5) Purchase principal only (PO) stripped mortgage-backed securities to reduce interest rate risk;

(6) Purchase CMOs/REMICs using fewer prepayment models than required in § 704.5(c)(6);

(7) Enter into a dollar roll transaction; and

(8) Engage in when-issued trading, when accounted for on a trade date basis.

(d) In performing the rate stress tests set forth in § 704.8(d)(1)(i), the NEV of a corporate credit union which has met the requirements of paragraph (a) of this Part II may decline as much as 50 percent.

(e) The maximum aggregate amount in secured and unsecured loans and irrevocable lines of credit to any one member credit union, excluding pass-through and guaranteed loans from the CLF and the NCUSIF, shall be established by the board of directors as a percentage of the corporate credit union's capital plus pledged shares.

Part III

(a) A corporate credit union which has met the requirements of paragraph (a) of either Part I or Part II of this Appendix may invest in:

(1) Debt obligations of a foreign country; and

(2) Deposits in, the sale of federal funds to, and debt obligations of foreign banks or obligations guaranteed by these banks.

(b) All foreign investments are subject to the following requirements:

(i) Short-term investments must be rated no lower than A–1 (or equivalent);

(ii) Long-term investments must be rated no lower than AA (or equivalent);

(iii) A sovereign issuer, and/or the country in which a bank issuer/guarantor is organized, must be rated no lower than AA (or equivalent) for political and economic stability;

(iv) A bank issuer/guarantor must be rated no lower than AA;

(v) For each approved foreign bank line, the corporate credit union must identify the spe-

cific banking centers and branches to which it will lend funds;

(vi) Non secured obligations of any single foreign issuer may not exceed 150 percent of the sum of reserves and undivided earnings and paid-in capital; and

(vii) Non secured obligations in any single foreign country may not exceed 500 percent of the sum of reserves and undivided earnings and paid-in capital.

Part IV

A corporate credit union which has met the requirements of paragraph (a) of either Part I or Part II of this Appendix may engage in derivatives transactions which are directly related to its financial activities and which have been specifically approved by NCUA. A corporate credit union may use such derivatives authority only for the purposes of creating structured instruments and hedging its own balance sheet and the balance sheets of its members.

Part 705

Community Development Revolving Loan Program For Credit Unions

§ 705.0 Applicability.

Monies from the Community Development Revolving Loan Fund for Credit Unions are governed by this Part.

§ 705.1 Scope.

(a) This Part implements the Community Development Revolving Loan Program for Credit Unions (Program) under the sole administration of the National Credit Union Administration.

(b) This Part establishes the following:

(1) Definitions;

(2) The application process and requirements for qualifying for a loan under the program;

(3) How loan funds are to be made available and their repayment; and

(4) Technical assistance to be provided to participating credit unions.

§ 705.2 Purpose of the Program.

(a) The Community Development Revolving Loan Program for Credit Unions is intended to support the efforts of participating credit unions through loans to those credit unions in:

(1) Providing basic financial and related services to residents in their communities; and

(2) Stimulating economic activities in the communities they service which will result in increased income, ownership and employment opportunities for low-income residents, and other community growth efforts.

(b) The policy of NCUA is to revolve loan funds to qualifying credit unions as often as practical in order to gain maximum economic impact on as many participating credit unions as possible.

§ 705.3 Definitions.

(a)(1) The term "low-income members" shall mean those members who make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or those members whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau or those members otherwise defined as low-income members as determined by order of the NCUA Board.

(2) In documenting its low-income membership, a credit union that serves a geographic area where a majority of residents fall at or below the annual income standard is presumed to be serving predominantly low-income members. In applying the standards, Regional Directors shall make allowances for geographical areas with higher costs of living. The following is the exclusive list of geographic areas and the differentials to be used:

	Percent
Hawaii	40
Alaska	36
Washington, DC	19
Boston	17
San Diego	15
Los Angeles	14
New York	13
San Francisco	13
Seattle	10
Chicago	7
Philadelphia	7

(b) For purposes of this part, a *participating credit union* means a state- or federally-chartered credit union (excluding student credit unions) that is specifically involved in the stimulation of economic development activities and community revitalization efforts aimed at benefiting the community it serves; whose membership consists of predominantly low-income members as defined in paragraph (a) of this section or applicable state standards as reflected by a current low-income designation pursuant to § 701.34(a)(1) or § 741.204 of this chapter or, in the case of a state-chartered nonfederally insured credit union, under applicable state standards; and has submitted an application for a loan and/or technical assistance and has been selected for participation in the Program in accordance with this part.

§ 705.4 Program Activities.

In order to meet the objectives of the Program, a credit union applicant should provide a variety of financial and related services designed to meet the particular needs of the low-income community served. These activities shall include basic member share accounts and member loan services.

§ 705.5 Application for Participation.

(a) Applications to participate and qualify for a loan or technical assistance under the Program may be obtained from the National Credit Union Administration, Community Development Revolving Loan Program for Credit Unions.

(b) The application for a loan shall contain the following information:

(1) Information demonstrating a sound financial position and the credit union's ability to manage its day-to-day business affairs, including the credit union's latest financial statement. Nonfederally insured credit unions must include the following:

(i) A copy of its most recent outside audit report;

(ii) Proof of deposit and surety bond insurance which states the maximum insurance levels permitted by the policies;

(iii) A balance sheet, an income and expense statement, and a schedule of delinquent loans, for the most recent month-end and each of the twelve months preceding that month-end.

(2) Evidence that the credit union has a need for increased funds in order to improve financial services to its members.

(3) The following information concerning a state-chartered credit union's field of membership:

(i) Current field of membership as set forth in the credit union's charter;

(ii) Changes, if any, to be made to the field of membership for participation in the Program, including:

(A) Evidence of approval of change by credit union board of directors;

(B) Evidence of submission and approval of change by the state supervisor;

(iii) Current designation as a low-income credit union if the credit union is not federally insured.

(4) Along with a community needs plan, specifics of how the credit union proposes to serve the needs of its members and the community with Program funds. The applicant credit union will also construct and submit a plan for its growth and development. The plan will set forth objectives for financial growth, credit union development and capitalization, and the means for achieving these objectives.

(5) Indication of any other involvement in existing community development programs of state and federal agencies.

(c) NCUA will notify applicant credit unions as to whether or not they have qualified for a loan or technical assistance under this Part. Reasons for nonqualification will be stated. Any applicant whose qualification is denied may appeal that decision to the NCUA Board.

§ 705.6 Community Needs Plan.

(a) The credit union's board of directors will prepare a Community Needs Plan and submit it with its loan application. The Plan will contain a list of needed community services that the credit union will provide.

(b) The credit union's board of directors will report on the progress of providing needed community services to the credit union members once a year, either at the annual meeting or in a written report sent to all members. The credit union will also submit the written report or a summary of the report given at the annual meeting to NCUA.

§ 705.7 Loans to Participating Credit Unions.

(a) *Amount and Recording of Loans.* A participating credit union will be eligible to receive up to $300,000, in the aggregate as determined by the NCUA Board, in the form of a loan from the Community Development Revolving Loan Fund for Credit Unions. The amount of the loan will be based on funds availability, the creditworthiness of the participating credit union, financial need, and a demonstrated capability of a participating credit union to provide financial and related services to its members. At the discretion of NCUA, a loan will be recorded by a participating credit union as either a note payable or a nonmember deposit.

(b) *Matching Requirements.* Participating credit unions will be encouraged to develop, as rapidly as possible, a permanent source of member shares.

(1) Generally loan monies made available must be matched by the participating credit

union by increasing its share deposits in an amount equal to the loan amount. However, any loan monies matched by member share deposits will be credited as two-for-one match. Nonmember share deposits accepted to meet the matching requirement are not subject to the 20 percent limitation on nonmember deposits under § 701.32. Participating credit unions must meet this matching requirement within one year of the approval of the loan application and must maintain the increase in the total amount of share deposits for the duration of the loan. Once the loan is repaid, nonmember share deposits accepted to meet the matching requirement are subject to § 701.32.

(2) Upon approval of its loan application, and before it meets its matching requirement, a participating credit union may receive the entire loan commitment in a single payment. If any funds are withheld, the remainder of the funds committed will be available to the participating credit union only after it has documented that it has met the match requirement for the total amount of the loan committed.

(3) Failure of a participating credit union to generate the required match within one year of the approval of the loan will result in the reduction of the loan proportionate to the amount of match actually generated. Payment of any additional funds initially approved will be limited as appropriate to reflect the revised amount of the loan approved. Any funds already advanced to the participating credit union in excess of the revised amount of loan approval must be repaid immediately to NCUA. Failure to repay such funds to NCUA upon demand shall result in the default of the entire loan.

(c) *Terms and Repayment.* (1) Assistance made available through Program loans, whether recorded by the credit union as a note payable or nonmember deposit at NCUA's direction, is in the form of a loan and must be repaid to NCUA. All loans will be scheduled for repayment within the shortest time compatible with sound business practices and with objectives of the Program, but in no case will the term exceed five years.

(2) Semiannual interest payments (beginning six months after the initial distribution of a loan) and semiannual principal payments (beginning one year after the initial distribution of a loan) will be required.

(d) *Interest Rates.* Loans made under this Part shall bear interest at a fixed annual percentage rate of not more than 3 percent and not less than 1 percent as determined by the NCUA Board.

(e) *Default, Collections and Adjustments.* The terms of each loan agreement shall provide for the immediate acceleration of the unpaid balance for breach or default in the performance by the participating credit union of the terms or conditions of the loan. This will include misrepresentations, default in making interest/principal payments, failure to report, insolvency, failure to maintain adequate match for the duration of the loan period, etc. The unpaid balance will also be accelerated and immediately due if any part of the loan funds are improperly used, or if uninvested loan proceeds remain unused for an unreasonable or unjustified period of time.

§ 705.8 State-Chartered Credit Unions.

State-chartered credit union loan applicants approved for participation by NCUA must obtain written concurrence from their respective state regulatory authority. Such applicants shall make copies of their state examination reports available to NCUA and shall agree to examination by NCUA for the limited purpose of compliance with this Part.

§ 705.9 Application Period.

NCUA will announce annually and publish in the Federal Register when applications for participation in the Program may be submitted. Such notice will be dependent upon the availability of funds.

§ 705.10 Technical Assistance.

Based on available earnings, NCUA may contract with outside providers to render technical assistance to participating credit unions. Participating credit unions can be provided with technical assistance without obtaining a Program loan. NCUA technical assistance will aid participating credit unions in providing services to their members and in the efficient operation of such credit unions.

Part 706

Credit Practices

§ 706.1 Definitions.

(a) *Person.* An individual, corporation, or other business organization.

(b) *Consumer.* A natural person member who seeks or acquires goods, services, or money for personal, family, or household use.

(c) *Obligation.* An agreement between a consumer and a Federal credit union.

(d) *Debt.* Money that is due or alleged to be due from one to another.

(e) *Earnings.* Compensation paid or payable to an individual or for his or her account for personal services rendered or to be rendered by him or her, whether denominated as wages, salary, commission, bonus, or otherwise, including periodic payments pursuant to a pension, retirement, or disability program.

(f) *Household goods.* Clothing, furniture, appliances, one radio and one television, linens, china, crockery, kitchenware, and personal effects (including wedding rings) of the consumer and his or her dependents, provided that the following are not included within the scope of the term "household goods":

(1) Works of art;

(2) Electronic entertainment equipment (except one television and one radio);

(3) Items acquired as antiques; and

(4) Jewelry (except wedding rings).

(g) *Antique.* Any item over one hundred years of age, including such items that have been repaired or renovated without changing their original form or character.

(h) *Cosigner.* A natural person who renders himself or herself liable for the obligation of another person without receiving goods, services, or money in return for the credit obligation, or, in the case of an open-end credit obligation, without receiving the contractual right to obtain extensions of credit under the obligation. The term includes any person whose signature is requested as a condition to granting credit to a consumer, or as a condition for forbearance on collection of a consumer's obligation that is in default. The term does not include a spouse whose signature is required on a credit obligation to perfect a security interest pursuant to state law. A person is a cosigner within the meaning of this definition whether or not he or she is designated as such on a credit obligation.

§ 706.2 Unfair Credit Practices.

(a) In connection with the extension of credit to consumers, it is an unfair act or practice for a Federal credit union, directly or indirectly, to take or receive from a consumer an obligation that:

(1) Constitutes or contains a cognovit or confession of judgment (for purposes other than executory process in the State of Louisiana), warrant of attorney, or other waiver of the right to notice and the opportunity to be heard in the event of suit or process thereon.

(2) Constitutes or contains an executory waiver or a limitation of exemption from attachment, execution, or other process on real or personal property held, owned by, or due to the consumer, unless the waiver applies solely to property subject to a security interest executed in connection with the obligation.

(3) Constitutes or contains an assignment of wages or other earnings unless:

(i) The assignment by its terms is revocable at the will of the debtor, or

(ii) The assignment is a payroll deduction plan or preauthorized payment plan, commencing at the time of the transaction, in which the consumer authorizes a series of wage deductions as a method of making each payment, or

(iii) The assignment applies only to wages or other earnings already earned at the time of the assignment.

(4) Constitutes or contains a nonpossessory security interest in household goods other than a purchase money security interest.

§ 706.3 Unfair or Deceptive Cosigner Practices.

(a) *Prohibited practices.* In connection with the extension of credit to consumers, it is:

(1) A deceptive act or practice for a Federal credit union, directly or indirectly, to misrepresent the nature or extent of cosigner liability to any person.

(2) An unfair act or practice for a Federal credit union, directly or indirectly, to obligate a cosigner unless the cosigner is informed prior to becoming obligated, which in the case of open-end credit means prior to the time that the agreement creating the cosigner's liability for future charges is executed, of the nature of his or her liability as cosigner.

(b) Disclosure requirement.

(1) To comply with the cosigner information requirement of paragraph (a)(2), a clear and conspicuous disclosure statement shall be given in writing to the cosigner prior to becoming obligated. The disclosure statement will contain only the following statement, or one which is substantially equivalent, and shall either be a separate document or included in the documents evidencing the consumer credit obligation.

NOTICE TO COSIGNER

> You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.
>
> You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.
>
> The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of your credit record.
>
> This notice is not the contract that makes you liable for the debt.

(2) If the notice to cosigner is a separate document, nothing other than the following items may appear with the notice. Items (i) through (v) may not be part of the narrative portion of the notice to cosigner.

(i) The name and address of the Federal credit union;

(ii) An identification of the debt to be cosigned (e.g., a loan identification number);

(iii) The amount of the loan;

(iv) The date of the loan;

(v) A signature line for a cosigner to acknowledge receipt of the notice; and

(vi) To the extent permitted by state law, a cosigner notice required by state law may be included in the paragraph (b)(1) notice.

(3) To the extent the notice to cosigner specified in paragraph (b)(1) refers to an action against a cosigner that is not permitted by state law, the notice to cosigner may be modified.

§ 706.4 Late Charges.

(a) In connection with collecting a debt arising out of an extension of credit to a consumer, it is an unfair act or practice for a Federal credit union, directly or indirectly, to levy or collect any delinquency charge on a payment, which payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, when the only delinquency is attributable to late fee(s) or delinquency charge(s) assessed on earlier installment(s).

(b) For purposes of this section, "collecting a debt" means any activity other than the use of judicial process that is intended to bring about or does bring about repayment of all or part of a consumer debt.

§ 706.5 State Exemptions.

(a) If, upon application to the NCUA by an appropriate state agency, the NCUA determines that:

(1) there is a state requirement or prohibition in effect that applies to any transaction to which a provision of this rule applies; and

(2) the state requirement or prohibition affords a level of protection to consumers that is substantially equivalent to, or greater than, the protection afforded by this rule; then that provision of this rule will not be in effect in the state to the extent specified by the NCUA in its determination, for as long as the state administers and enforces the state requirement or prohibition effectively.

(b) States that received an exemption from the Federal Trade Commission's Credit Practices Rule prior to September 17, 1987, are not required to reapply to NCUA for an exemption under subparagraph (a) of this section provided that the state forwards a copy of its exemption determination to the appropriate Regional Office. NCUA will honor the exemption for as long as the state administers and enforces the state requirement or

prohibition effectively. Any state seeking a greater exemption than that granted to it by the Federal Trade Commission must apply to NCUA for the exemption.

Part 707

Truth in Savings

§ 707.1 Authority, purpose, coverage and effect on state laws.

(a) *Authority.* This part is issued by the National Credit Union Administration Board to implement the Truth in Savings Act of 1991 (TISA), contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. § 4301 *et seq.*, Pub. L. No. 102–242, 105 Stat. 2236).

(b) *Purpose.* The purpose of this part is to enable credit union members and potential members to make informed decisions about accounts at credit unions. This part requires credit unions to provide disclosures so that members and potential members can make meaningful comparisons among credit unions and depository institutions.

(c) *Coverage.* This part applies to all credit unions whose accounts are either insured by, or eligible to be insured by, the National Credit Union Share Insurance Fund, except for any credit union that has been designated as a corporate credit union by the National Credit Union Administration and any credit union that has $2 million or less in assets, after subtracting any nonmember deposits, and is determined to be nonautomated by the National Credit Union Administration. In addition, the advertising rules in § 707.8 apply to any person who advertises an account offered by a credit union, including any person who solicits any amount from any other person for placement in a credit union.

(d) *Effect on state laws.* State law requirements that are inconsistent with the requirements of the TISA and this part are preempted to the extent of the inconsistency.

§ 707.2 Definitions.

For purposes of this part, the following definitions apply:

(a) *Account* means a share or deposit account at a credit union held by or offered to a member or potential member. It includes, but is not limited to, accounts such as share, share draft, checking and term share accounts. For purposes of the advertising regulations in § 707.8, the term also includes an account at a credit union that is held by or offered by a share or deposit broker.

(b) *Advertisement* means a commercial message, appearing in any medium, that promotes directly or indirectly the availability of, or a deposit in, an account.

(c) *Annual percentage yield* means a percentage rate reflecting the total amount of dividends paid on an account, based on the dividend rate and the frequency of compounding for a 365-day period and calculated according to the rules in Appendix A of this part.

(d) *Average daily balance method* means the application of a periodic rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

(e) *Board* means the National Credit Union Administration Board.

(f) *Bonus* means a premium, gift, award, or other consideration worth more than $10 (whether in the form of cash, credit, merchandise, or any equivalent) given or offered to a member during a year in exchange for opening, maintaining, or renewing an account, or increasing an account balance. The term does not include dividends, other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or extraordinary dividends.

(g) *Credit union* means a federal or state-chartered credit union that is either insured by, or is eligible to apply for insurance from, the National Credit Union Share Insurance Fund.

(h) *Daily balance method* means the application of a daily periodic rate to the full amount of principal in the account each day.

(i) *Dividend and dividends* mean any declared or prospective earnings on a member's shares in a credit union to be paid to a member or to the member's account. For purposes of this part, the term does not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or extraordinary dividends.

(j) *Dividend declaration date* means the date that the board of directors of a credit union de-

clares a dividend for the preceding dividend period.

(k) *Dividend period* means the span of time established by the board of directors of a credit union by the end of which shares in a member account earn dividend credit. The dividend period may be different for each type of account.

(l) *Dividend rate* means the declared or prospective annual dividend rate paid on an account, which does not reflect compounding. For purposes of the account disclosures in § 707.4(b)(1)(i), the rate may, but need not, be referred to as the "annual percentage rate" in addition to being referred to as the "dividend rate."

(m) *Extraordinary dividends* means a nonrepetitive dividend paid at an irregular time from funds legally available for such distribution.

(n) *Fixed-rate account* means an account that is not a variable rate account as defined in paragraph (z) of this section.

(o) *Grace period* means a period following the maturity of an automatically renewing term share account during which the member may withdraw funds without being assessed a penalty.

(p) *Interest* means any payment to a member or to a member's account for the use of funds in a nondividend-bearing account at a state-chartered credit union offered pursuant to state law, calculated by application of a periodic rate to the balance. For purposes of this regulation, the term does not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or extraordinary dividends. Except as is specifically otherwise provided in this part, in the case of an interest-bearing account held in or offered by a state-chartered credit union pursuant to state law, the word "interest" shall be substituted for all references to "dividend" or "dividends" in this part.

(q) *Member* means:

(1) A natural person member of the credit union who holds an account primarily for personal, family, or household purposes;

(2) A natural person nonmember who holds an account primarily for personal, family, or household purposes, either jointly with a natural person member or in a credit union designated as a low-income credit union, or to whom such an account is offered; and

(3) A natural person nonmember who holds a deposit account in a state-chartered credit union pursuant to state law, or to whom such deposit account is offered.

The term does not include a natural person who holds an account for another in a professional capacity or an unincorporated nonbusiness association of natural person members.

(r) *Non-dividend membership benefits* means any property or service provided by a credit union to its members, the nature of which makes its valuation unreasonable and administratively impracticable.

(s) *Passbook account* means an account in which the member retains a book or other document in which the credit union records transactions on the account.

(t) *Periodic statement* means a statement setting forth information about an account (other than a term share account or passbook account) that is provided to a member on a regular basis four or more times a year.

(u) *Potential member* means a natural person within the credit union's field of membership (or an unincorporated nonbusiness association of such persons) or otherwise eligible to become a member as defined in paragraph (q) of this section.

(v) *State* means a state, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

(w) *Stepped-rate account* means an account that has two or more dividend rates that take effect in succeeding periods and are known when the account is opened.

(x) *Term share account* means any share certificate, interest-bearing certificate of deposit account, or other account with a maturity of at least seven days in which the member generally does not have a right to make withdrawals for six days after the account is opened, unless the account is subject to an early withdrawal penalty of at least seven days' dividends on amounts withdrawn, offered by a credit union to a member or potential member.

(y) *Tiered-rate account* means an account that has two or more dividend rates that are applicable to specified balance levels.

(z) *Variable-rate account* means a share, share draft, checking, or term share account in which the simple dividend rate may change after the account is opened, unless the credit union contracts to give at least thirty days advance written notice of rate decreases.

§ 707.3 General disclosure requirements.

(a) *Form.* Credit unions shall make the disclosures required by §§ 707.4 through 707.6, as applicable, clearly and conspicuously in writing and

in a form that the member or potential member may keep. Disclosures for each account offered by a credit union may be presented separately or they may be combined with disclosures for the credit union's other accounts, as long as it is clear which disclosures are applicable to the member's account.

(b) *General.* The disclosures shall reflect the terms of the legal obligation between the member and the credit union. Disclosures may be made in languages other than English, provided the disclosures are available in English upon request.

(c) *Relation to Regulation E (12 CFR part 205).* Disclosures required by and provided in accordance with the Electronic Fund Transfer Act (15 U.S.C. 1601) and its implementing Regulation E (12 CFR part 205) that are also required by this part may be substituted for the disclosures required by this part.

(d) *Multiple members.* If an account is held by more than one member, disclosures may be made to any one of the members.

(e) *Oral responses to inquiries.* In an oral response to a member or potential member's inquiry about dividend rates payable on its accounts, the credit union shall state the annual percentage yield. The dividend rate may be stated in addition to the annual percentage yield. No other rate may be stated. In stating a dividend rate and annual percentage yield, a credit union shall:

(1) For dividend-bearing accounts other than term share accounts, specify a dividend rate and annual percentage yield as of the last dividend declaration date. In the event that disclosures of a dividend rate and annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective dividend rate and prospective annual percentage yield. Such prospective dividend rate and prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(2) For interest-bearing accounts and for dividend-bearing term share accounts, specify an interest (dividend) rate and annual percentage yield that were offered within the most recent seven calendar days; state that the rate and yield are accurate as of an identified date; and provide a telephone number members may call to obtain current rate information.

(f) *Rounding and accuracy rules for rates and yields.*

(1) *Rounding.* The annual percentage yield, the annual percentage yield earned, and the dividend rate shall be rounded to the nearest one-hundredth of one percentage point (.01%) and expressed to two decimal places. For account disclosures, the dividend rate may be expressed to more than two decimal places.

(2) *Accuracy.* The annual percentage yield (and the annual percentage yield earned) will be considered accurate if not more than one-twentieth of one percentage point (.05%) above or below the annual percentage yield (and the annual percentage yield earned) determined in accordance with the rules in Appendix A of this part.

§ 707.4 Account disclosures.

(a) *Delivery of account disclosures.*

(1) *Account opening.* The credit union shall provide the account disclosures to the member or potential member before an account is opened or a service is provided, whichever is earlier. A credit union is deemed to have provided a service when a fee required to be disclosed is assessed. If the member is not present at the credit union when the account is opened or a service is provided and has not already received the disclosures, the credit union shall mail or deliver the disclosures no later than twenty calendar days after the account is opened or the service is provided, whichever is earlier.

(2) *Requests.*

(i) A credit union shall provide the account disclosures to any member or potential member upon request. A credit union may provide the account disclosures to nonmembers in its sole discretion. If the member is not present at the credit union when the request is made, the credit union shall mail or deliver the disclosures within a reasonable time after it receives the request.

(ii) In providing disclosures upon request, the credit union may:

(A) Specify rates as follows:

(*1*) For dividend-bearing accounts other than term share accounts, specify a dividend rate and annual percentage yield as of the last dividend declaration date. In the event that disclosures of a dividend rate and annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective divi-

dend rate and prospective annual percentage yield. Such prospective dividend rate and prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(*2*) For interest-bearing accounts and for dividend-bearing term share accounts, specify an interest rate and annual percentage yield that were offered within the most recent seven calendar days; state that the rate and yield are accurate as of an identified date; and provide a telephone number members may call to obtain current rate information; and

(B) State the maturity of a term share account as either a term or a date.

(b) Content of account disclosures. Account disclosures shall include the following, as applicable:

(1) *Rate information.*

(i) *Annual percentage yield and dividend rate.*

(A) For interest-bearing accounts and for dividend-bearing term share accounts, the "annual percentage yield" and the "interest rate" ("dividend rate"), using those terms, and for fixed-rate accounts the period of time the interest (dividend) rate will be in effect.

(B) For dividend-bearing accounts other than term share accounts, a credit union shall specify a dividend rate and annual percentage yield (using those terms) as of the last dividend declaration date. In the event that disclosures of a dividend rate and annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective dividend rate and prospective annual percentage yield. Such prospective dividend rate and prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(ii) *Variable rates.* For variable-rate accounts:

(A) The fact that the dividend rate and annual percentage yield may change;

(B) How the dividend rate is determined;

(C) The frequency with which the dividend rate may change; and

(D) Any limitation on the amount the dividend rate may change.

(2) *Compounding and crediting.*

(i) *Frequency.* The frequency with which dividends are compounded and credited, and the dividend period for dividend-bearing accounts.

(ii) *Effect of closing an account.* If members will forfeit dividends if they close an account before accrued dividends are credited, a statement that the dividends will not be paid in such cases.

(3) *Balance information.*

(i) *Minimum balance requirements.* Any minimum balance required to:

(A) Open the account;

(B) Avoid the imposition of a fee; or

(C) Obtain the annual percentage yield disclosed.

Except for the balance to open the account, the disclosure shall state how the balance is determined for these purposes.

(ii) *Balance computation method.* An explanation of the balance computation method specified in § 707.7, used to calculate dividends on the account.

(iii) *When dividends begin to accrue.* A statement of when dividends begin to accrue on noncash deposits.

(4) *Fees.* The amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed.

(5) *Transaction limitations.* Any limitations on the number or dollar amount of withdrawals or deposits.

(6) *Features of Term Share Accounts.* For term share accounts:

(i) *Time requirements.* The maturity date.

(ii) *Early withdrawal penalties.* A statement that a penalty will be imposed for early withdrawal, how it is calculated, and the conditions for its assessment.

(iii) *Withdrawal of dividends prior to maturity.* If compounding occurs and dividends may be withdrawn prior to maturity, a statement that the annual percentage yield assumes dividends remain in the account until maturity and that a withdrawal will reduce earnings.

(iv) *Renewal policies.* A statement of whether or not the account will renew automatically at maturity. If it will, a statement of whether or not a grace period will be provided and, if so, the length of that period must be stated. If the account will not renew automatically, a statement of whether dividends will be paid after maturity if the member does not renew the account must be stated.

(7) *Bonuses.* The amount or type of any bonus, when the bonus will be provided, and any minimum balance and time requirements to obtain the bonus.

(8) *Nature of dividends.* For accounts earning dividends, other than term share accounts, a statement that dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

(c) *Notice to existing account holders.*

(1) *Notice of availability of disclosures.* Credit unions shall provide a notice to members who receive periodic statements and who hold existing accounts of the type offered by the credit union on January 1, 1995. The notice shall be included on or with the first periodic statement sent after January 1, 1995 (or on or with the first periodic statement for a statement cycle beginning on or after that date). The notice shall state that the members may request account disclosures containing terms, fees, and rate information for the account. In responding to such a request, credit unions shall provide disclosures in accordance with paragraph (a)(2) of this section.

(2) *Alternative to notice.* As an alternative to the notice described in paragraph (c)(1) of this section, credit unions may provide account disclosures to members. The disclosures may be provided either with a periodic statement or separately, but must be sent no later than when the periodic statement described in paragraph (c)(1) of this section is sent.

§ 707.5 Subsequent disclosures.

(a) *Change in terms.*

(1) *Advance notice required.* A credit union shall give advance notice to affected members of any change in a term required to be disclosed under § 707.4(b), if the change may reduce the annual percentage yield or adversely affect the member. The notice shall include the effective date of the change. The notice shall be mailed or delivered at least 30 calendar days before the effective date of the change.

(2) *No notice required.* No notice under this section is required for:

(i) *Variable-rate changes.* Changes in the dividend rate and corresponding changes in the annual percentage yield in variable-rate accounts.

(ii) *Share draft and check printing fees.* Changes in fees for check printing.

(iii) *Short-term term share accounts.* Changes in any term for term share accounts with maturities of one month or less.

(b) *Notice before maturity for term share accounts longer than one month that renew automatically.* For term share accounts with a maturity longer than one month that renew automatically at maturity, credit unions shall provide the disclosures described below before maturity. The disclosures shall be mailed or delivered at least 30 calendar days before maturity of the existing account. Alternatively, the disclosures may be mailed or delivered at least 20 calendar days before the end of the grace period on the existing account, provided a grace period of at least five calendar days is allowed.

(1) *Maturities of longer than one year.* If the maturity is longer than one year, the credit union shall provide account disclosures set forth in § 707.4(b) for the new account, along with the date the existing account matures. If the dividend rate and annual percentage yield that will be paid for the new account are unknown when disclosures are provided, the credit union shall state that those rates have not yet been determined, the date when they will be determined, and a telephone number members may call to obtain the dividend rate and the annual percentage yield that will be paid for the new account.

(2) *Maturities of one year or less but longer than one month.* If the maturity is one year or less but longer than one month, the credit union shall either:

(i) Provide disclosures as set forth in paragraph (b)(1) of this section; or

(ii) Disclose to the member:

(A) The date the existing account matures and the new maturity date if the account is renewed;

(B) The dividend rate and the annual percentage yield for the new account if they are known (or that those rates have not yet been determined, the date when they will be determined, and a telephone number the member may call to obtain the dividend rate and the annual percentage yield that will be paid for the new account); and

(C) Any difference in the terms of the new account as compared to the terms required to be disclosed under § 707.4(b) for the existing account.

(c) *Notice for term share accounts one month or less that renew automatically.* For term share accounts with a maturity one month or less that renew automatically at maturity, credit unions shall disclose any difference in the terms of the new account as compared to the terms required to be disclosed under § 707.4(b) for the existing account, other than a change in the dividend rate and corresponding change in the annual percentage yield. The notice shall be mailed or delivered within a reasonable time after the renewal.

(d) *Notice before maturity for term share accounts longer than one year that do not renew automatically.* For term share accounts with a maturity longer than one year that do not renew automatically at maturity, credit unions shall disclose to members the maturity date and whether dividends will be paid after maturity. The disclosures shall be mailed or delivered at least 10 calendar days before maturity of the existing account.

§ 707.6 Statement disclosures.

(a) *Rule when statement and crediting periods vary.* In making the disclosures described in paragraph (b) of this section, credit unions that calculate and credit dividends for a period other than the statement period, such as the dividend period, may calculate and disclose the annual percentage yield earned and amount of dividends earned based on that period rather than the statement period. The information in paragraph (b)(4) shall be stated for that period as well as for the statement period.

(b) *Statement disclosures.* If a credit union mails or delivers a periodic statement, the statement shall include the following disclosures:

(1) *Annual percentage yield earned.* The "annual percentage yield earned," using that term as calculated according to the rules in Appendix A of this part.

(2) *Amount of dividends.* The dollar amount of dividends earned (accrued or paid and credited) on the account. The dollar amount of any extraordinary dividends earned during the statement period shall be shown as a separate figure.

(3) *Fees imposed.* Fees required to be disclosed under § 707.4(b)(4) of this part and imposed on the account during the statement period. The fees shall be itemized by type and dollar amounts.

(4) *Length of period.* The total number of days in the statement period, or the beginning and ending dates of the period.

§ 707.7 Payment of dividends.

(a) *Permissible methods.*

(1) *Balance on which dividends are calculated.* Credit unions shall calculate dividends on the full amount of principal in an account for each day by use of either the daily balance method or the average daily balance method. Credit unions shall calculate dividends by use of a daily rate of at least 1/365 of the dividend rate. In a leap year a daily rate of 1/366 of the dividend rate may be used.

(2) *Determination of minimum balance to earn dividends.* A credit union shall use the same method to determine any minimum balance required to earn dividends as it uses to determine the balance on which dividends are calculated. A credit union may use an additional method that is unequivocally beneficial to the member.

(b) *Compounding and crediting policies.* This section does not require credit unions to compound or credit dividends at any particular frequency.

(c) *Date dividends begin to accrue.* Dividends shall begin to accrue not later than the day specified in § 606 of the Expedited Funds Availability Act (12 U.S.C. 4005) and implementing Regulation CC (12 CFR part 229). Dividends shall accrue on funds until the day funds are withdrawn.

§ 707.8 Advertising.

(a) *Misleading or inaccurate advertisements.* An advertisement shall not be misleading or inaccurate and shall not misrepresent a credit union's account contract. An advertisement shall not refer to or describe an account as "free" or "no cost" (or contain a similar term) if any maintenance or activity fee may be imposed on the account. The word "profit" shall not be used in referring to interest paid on an account.

(b) *Permissible rates.* If an advertisement states a rate of return, it shall state the rate as an "annual percentage yield," using that term. (The abbreviation "APY" may be used provided the term "annual percentage yield" is stated at least once in the advertisement.) The advertisement shall not state any other rate, except that the "dividend rate," using that term, may be stated in conjunc-

tion with, but not more conspicuously than, the annual percentage yield to which it relates.

(c) *When additional disclosures are required.* Except as provided in paragraph (e) of this section, if the annual percentage yield is stated in an advertisement shall state the following information, to the extent applicable, clearly and conspicuously:

(1) *Variable rates.* For variable-rate accounts, a statement that the rate may change after the account is opened.

(2) *Time annual percentage yield is offered.* For interest-bearing accounts and dividend-bearing term share accounts, the period of time the annual percentage yield will be offered, or a statement that the annual percentage yield is accurate as of a specified date. For dividend-bearing accounts other than term share accounts, a statement that the annual percentage yield is accurate as of the last dividend declaration date. In the event that disclosure of an annual percentage yield as of the last dividend declaration date might be inaccurate because of known or contemplated dividend rate changes, the credit union may disclose the prospective annual percentage yield. Such prospective annual percentage yield may be disclosed either in lieu of, or in addition to, the dividend rate and annual percentage yield as of the last dividend declaration date.

(3) *Minimum balance.* The minimum balance required to earn the advertised annual percentage yield. For tiered-rate accounts, the minimum balance required for each tier shall be stated in close proximity and with equal prominence to the applicable annual percentage yield.

(4) *Minimum opening deposit.* The minimum deposit required to open the account, if it is greater than the minimum balance necessary to earn the advertised annual percentage yield.

(5) *Effect of fees.* A statement that fees could reduce the earnings on the account.

(6) *Features of term share accounts.* For term share accounts:

(i) *Time requirements.* The term of the account.

(ii) *Early withdrawal penalties.* A statement that a penalty will or may be imposed for early withdrawal.

(d) *Bonuses.* Except as provided in paragraph (e) of this section, if a bonus is stated in an advertisement, the advertisement shall state the following information, to the extent applicable, clearly and conspicuously:

(1) The "annual percentage yield," using that term;

(2) The time requirements to obtain the bonus;

(3) The minimum balance required to obtain the bonus;

(4) The minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus; and

(5) When the bonus will be provided.

(e) *Exemption for certain advertisements.*

(1) *Certain media.* If an advertisement is made through one of the following media, it need not contain the information in paragraphs (c)(1), (c)(2), (c)(4), (c)(5), (c)(6)(ii), (d)(4) and (d)(5) of this section:

(i) Broadcast or electronic media, such as television or radio;

(ii) Outdoor media, such as billboards; or

(iii) Telephone response machines.

(2) *Indoor signs.*

(i) Signs inside the premises of a credit union (or the premises of a share or deposit broker) are not subject to paragraphs (b), (c), (d) or (e)(1) of this section unless they face outside the premises and can reasonably be viewed by a member only from outside the premises.

(ii) If a sign exempted by paragraph (e)(2) of this section states a rate of return, it shall:

(A) State the rate as an "annual percentage yield," using that term or the term "APY." The sign shall not state any other rate, except that the dividend rate may be stated in conjunction with the annual percentage yield to which it relates.

(B) Contain a statement advising members to contact an employee for further information about applicable fees and terms.

(3) *Newsletters.*

(i) Newsletters sent by a credit union to existing members only are not subject to paragraphs (b), (c), (d) or (e)(1) of this section.

(ii) If a newsletter exempted by paragraph (e)(3) of this section states a rate of return, it shall:

(A) State the rate as an "annual percentage yield," using that term or the term "APY." The newsletter shall not state any other rate, except that the dividend rate may be stated in conjunction with the annual percentage yield to which it relates.

(B) Contain a statement advising members to contact an employee for further information about applicable fees and terms.

§ 707.9 Enforcement and record retention.

(a) *Administrative enforcement.* Section 270 of TISA (12 U.S.C. 4309) contains the provisions relating to administrative sanctions for failure to comply with the requirements of TISA and this part.

(b) *Civil liability.* Section 271 of TISA (12 U.S.C. 4310) contains the provisions relating to civil liability for failure to comply with the requirements of TISA and this regulation.

(c) *Record retention.* A credit union shall retain evidence of compliance with this regulation for a minimum of two years after the date disclosures are required to be made or action is required to be taken.

Appendix A to Part 707—Annual Percentage Yield Calculation

The annual percentage yield (APY) measures the total amount of dividends a credit union pays on an account based on the dividend rate and the frequency of compounding. The annual percentage yield is expressed as an annualized rate, based on a 365-day year. (Credit unions may calculate the annual percentage yield based on a 365-day or a 366-day year in a leap year.) Part I of this appendix discusses the annual percentage yield calculations for account disclosures and advertisements, while Part II discusses annual percentage yield earned calculations for statements. The annual percentage yield reflects only dividends and does not include the value of any bonus, as that term is defined in part 707, that may be provided to the member to open, maintain, increase or renew an account. Dividends, interest or other earnings are not to be included in the annual percentage yield if such amounts are determined by circumstances that may or may not occur in the future. These formulas apply to both dividend-bearing and interest-bearing accounts held by credit unions.

Part I. Annual Percentage Yield for Account Disclosures and Advertising Purposes

In general, the annual percentage yield for account disclosures under §§ 707.4 and 707.5 and for advertising under § 707.8 is an annualized rate that reflects the relationship between the amount of dividends that would be earned by the member for the term of the account and the amount of principal used to calculate those dividends. The amount of dividends that would be earned may be projected based on the most recent past declared rate or an anticipated future rate, whichever the credit union judges to most reasonably approximate the dividends to be earned. Special rules apply to accounts with tiered and stepped dividend rates.

A. General rules

The annual percentage yield shall be calculated for all accounts by the formula shown below. Credit unions may calculate the annual percentage yield using projected dividends based on either the rate at the last dividend declaration date or the rate anticipated at a future date. The credit union must disclose whichever option it uses to members. Credit unions shall calculate the annual percentage yield based on the actual number of days for the term of the account. For accounts without a stated maturity date (such as a typical share or share draft account), the calculation shall be based on an assumed term of 365 days. In determining the total dividends figure to be used in the formula, credit unions shall assume that all principal and dividends remain on deposit for the entire term, and that no other transactions (deposits or withdrawals) occur during the term. (This assumption shall not be used if a credit union requires, as a condition of the account, that members withdraw dividends during the term. In such a case, the dividends (and annual percentage yield calculation) shall reflect that requirement.) For term share accounts that are offered in multiples of months, credit unions may base the number of days on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar months. If credit unions choose to use this permissive rule, they must use the same number of days to calculate the dollar amount of dividends that will be earned on the account in the annual percentage yield formula (where "Dividends" are divided by "Principal".)

The annual percentage yield is to be calculated by use of the following general formula (("APY") is used for convenience in the formulas):

$$APY = 100[(1 + Dividends/Principal)^{(365/Days\ in\ term)} - 1]$$

"Principal" is the amount of funds assumed to have been deposited at the beginning of the account.

"Dividends" is the total dollar amount of dividends earned on the Principal for the term of the account.

"Days in term" is the actual number of days in the term of the account.

When the "days in term" is 365 (that is, where the stated maturity is 365 days or where the account does not have a stated maturity), the APY can be calculated by use of the following simple formula:

$$APY = 100\ (Dividends/Principal).$$

EXAMPLES:

(1) If a credit union would pay $61.68 in dividends for a 365-day year on $1,000 deposited into a share draft account, the APY is 6.17%:
$APY = 100 [(1 + 61.68/1,000)^{(365/365)} - 1]$

APY = 6.17%

Or, using the simple formula above (since the term is deemed to be 365 days):

APY = 100 (61.68/1,000)

APY = 6.17%

(2) If a credit union pays $30.37 in dividends on a $1,000 six-month term share certificate account (where the six-month period used by the credit union contains 182 days), using the general formula above, the APY is 6.18%:
$APY = 100 [(1 + 30.37/1,000)^{(365/182)} - 1]$

APY = 6.18%

The APY is affected by the frequency of compounding, i.e., the amount of dividends will be greater the more frequently dividends are compounded for a given nominal rate. When two credit unions are offering the same dividend rate on, for example, a share account, the APY disclosed may be different if the credit unions use a different frequency of compounding.

EXAMPLES:

(1) If a credit union pays $1,268.25 in dividends for a 365-day year on $10,000 deposited into a regular share account earning 12%, and the dividends are compounded monthly, the APY will be 12.68%:

APY = 100 ($1,268.25/10,000)

APY = 12.68%

(2) However, if a credit union is compounding dividends on a quarterly basis on an account which otherwise has the same terms, the dividends will be $1,255.09 and the APY will be 12.55%:

APY = 100 ($1,255.09/10,000)

APY = 12.55%

B. Stepped-Rate Accounts (Different Rates Apply in Succeeding Periods)

For accounts with two or more dividend rates applied in succeeding periods (where the rates are known at the time the account is opened), a credit union shall assume each dividend rate is in effect for the length of time provided for in any share agreement.

EXAMPLES:

(1) If a credit union offers a $1,000 6-month term share (certificate) account on which it pays a 5% dividend rate, compounded daily, for the first three months (which contain 91 days), and a 5.5% dividend rate, compounded daily, for the next three months (which contain 92 days), the total dividends for six months is $26.68, and, using the general formula above, the APY is 5.39%:
$APY = 100 [(1 + 26.68/1,000)^{(365/183)} - 1]$

APY = 5.39%

(2) If a credit union offers a $1,000 2-year share certificate on which it pays a 6% dividend rate, compounded daily, for the first year, and a 6.5% dividend rate, compounded daily, for the next year, the total dividends for two years is $133.13, and, using the general formula above, the APY is 6.45%:
$APY = 100[(1 + 133.13/1,000)^{(365/730)} - 1]$

APY = 6.45%

C. Variable-Rate Accounts

For variable-rate accounts without an introductory premium or discounted rate, a credit union must base the calculation only on the initial dividend rate in effect when the account is opened (or advertised), and assume that this rate will not change during the year.

Variable-rate accounts with an introductory premium or discount rate must be treated like stepped-rate accounts. Thus, a credit union shall assume that: (1) the introductory simple dividend rate is in effect for the length of time provided for in the account contract; and (2) the variable dividend rate that would have been in effect when the account is opened or advertised (but for the introductory rate) is in effect for the remainder of the year. If the variable rate is tied to an index, the index-based rate in effect at the time of disclosure must be used for the remainder of the year. If the rate is not tied to an index, the rate in effect for existing members holding the same account (who are not receiving the introductory dividend rate) must be used for the remainder of the year.

For example, if a credit union offers an account on which it pays a 7% dividend rate,

compounded daily, for the first three months (which, for example, contains 91 days), while the variable dividend rate that would have been in effect when the account was opened was 5%, the total dividends for a 365-day year for a $1,000 account balance is $56.52, (based on 91 days at 7% followed by 274 days at 5%). Using the simple formula, the APY is 5.65%:

APY = 100 (56.52/1,000)

APY = 5.65%

D. Accounts With Tiered Rates (Different Rates Apply To Specified Balance Level)

For accounts in which two or more dividend rates paid on the account are applicable to specified balance levels, the credit union must calculate the annual percentage yield in accordance with the method described below that it uses to calculate dividends. In all cases, an annual percentage yield (or a range of annual percentage yields, if appropriate) must be disclosed for each balance tier.

For purposes of the examples discussed below, assume the following:

Simple dividend rate	*Share balance required to earn rate*
5.25%	up to but not exceeding $2,500
5.50%	above $2,500, but not exceeding $15,000
5.75%	above $15,000.

Tiering Method A

Under this method, a credit union pays on the full balance in the account the stated dividend rate that corresponds to the applicable share balance tier. For example, if a member deposits $8,000, the credit union pays the 5.50% dividend rate on the entire $8,000. This is also known as a "hybrid" or "plateau" tiered rate account.

When this method is used to determine dividends, only one annual percentage yield will apply to each tier. Within each tier, the annual percentage yield will not vary with the amount of principal assumed to have been deposited.For the dividend rates and account balances assumed above, the credit union will state three annual percentage yields—one corresponding to each balance tier. Calculation of each annual percentage yield is similar for this type of account as for accounts with a single fixed dividend rate. Thus, the calculation is based on the total amount of dividends that would be received by the member for each tier of the account for a year and the principal assumed to have been deposited to earn that amount of dividends.

First tier. Assuming daily compounding, the credit union will pay $53.90 in dividends on a $1,000 account balance. Using the general formula for the first tier, the APY is 5.39%:

$$APY = 100 [(1 + 53.90/1,000)^{(365/365)} - 1]$$

APY = 5.39%

Using the simple formula:

APY = 100 (53.90/1,000)

APY = 5.39%

Second tier. The credit union will pay $452.29 in dividends on a $8,000 deposit. Thus, using the simple formula, the annual percentage yield for the second tier is 5.65%:

APY = 100 (452.29/8,000)

APY = 5.65%

Third tier. The credit union will pay $1,183.61 in dividends on a $20,000 account balance. Thus, using the simple formula, the annual percentage yield for the third tier is 5.92%:

APY = 100 (1,183.61/20,000)

APY = 5.92%

Tiering Method B

Under this method, a credit union pays the stated dividend rate only on that portion of the balance within the specified tier. For example, if a member deposits $8,000, the credit union pays 5.25% on only $2,500 and 5.50% on $5,500 (the difference between $8,000 and the first tier cutoff of $2,500). This is also known as a "pure" tiered rate account.

The credit union that computes dividends in this manner must provide a range that shows the lowest and the highest annual percentage yields for each tier (other than for the first tier, which, like the tiers in Method A, has the same annual percentage yield throughout). The low figure for an annual percentage yield is calculated based on the total amount of dividends earned for a year assuming the minimum principal required to earn the dividend rate for that tier. The high figure for an annual percentage yield is based on the amount of dividends the credit union would pay on the highest principal

that could be deposited to earn that same dividend rate. If the account does not have a limit on the amount that can be deposited, the credit union may assume any amount.

For the tiering structure assumed above, the credit union would state a total of five annual percentage yields—one figure for the first tier and two figures stated as a range for the other two tiers.

First tier. Assuming daily compounding, the credit union could pay $53.90 in dividends on a $1,000 account balance. For this first tier, using the simple formula, the annual percentage yield is 5.39%:

APY = 100 (53.90/1,000)

APY = 5.39%

Second tier. For the second tier the credit union would pay between $134.75 and $841.45 in dividends, based on assumed balances of $2,500.01 and $15,000, respectively. For $2,500.01, dividends would be figured on $2,500 at 5.25% dividend rate plus dividends on $.01 at 5.50%. For the low end of the second tier, therefore, the annual percentage yield is 5.39%. Using the simple formula:

APY = 100 (134.75/2,500)

APY = 5.39%

For $15,000, dividends are figured on $2,500 at 5.25% dividend rate plus dividends on $12,500 at 5.50% dividend rate. For the high end of the second tier, the annual percentage yield, using the simple formula, is 5.61%:

APY = 100 (841.45/15,000)

APY = 5.61%

Thus, the annual percentage yield range that would be stated for the second tier is 5.39% to 5.61%.

Third tier. For the third tier, the credit union would pay $841.45 and $5,871.78 in dividends on the low end of the third tier (a balance of $15,000.01). For $15,000.01, dividends would be figured on $2,500 at 5.25% dividend rate, plus dividends on $12,500 at 5.50% dividend rate, plus dividends on $.01 at 5.75% dividend rate. For the low end of the third tier, therefore, the annual percentage yield, using the simple formula, is 5.61%:

APY = 100 (841.45/15,000)

APY = 5.61%

Assuming the credit union does not limit the account balance, it may assume any maximum amount for the purposes of computing the annual percentage yield for the high end of the third tier. For an assumed maximum balance amount of $100,000, dividends would be figured on $2,500 at 5.25% dividend rate, plus dividends on $12,500 at 5.50% dividend rate, plus dividends on $85,000 at 5.75% dividend rate. For the high end of the third tier, therefore, the annual percentage yield, using the simple formula, is 5.87%:

APY = 100 (5,871.78/100,000)

APY = 5.87%

Thus, the annual percentage yield that would be stated for the third tier is 5.61% to 5.87%. If the assumed maximum balance amount is $1,000,000, credit unions would use $985,000 rather than $85,000 in the last calculation. In that case for the high end of the third tier, the annual percentage yield, using the simple formula, is 5.91%:

APY = 100 (59,134.22/ 1,000,000)

APY = 5.91%

Thus, the annual percentage yield range that would be stated for the third tier is 5.61% to 5.91%.

Part II. Annual Percentage Yield Earned for Statements

The annual percentage yield earned for statements under § 707.6 is an annualized rate that reflects the relationship between the amount of dividends actually earned (accrued or paid and credited) to the member's account during the period and the average daily balance in the account for the period over which the dividends were earned.

Pursuant to § 707.6(a), when dividends are paid less frequently than statements are sent, the APY Earned may reflect the number of days over which dividends were earned rather than the number of days in the statement period, e.g., if a credit union uses the average daily balance method and calculates dividends for a period other than the statement period, the annual percentage yield earned shall reflect the relationship between the amount of dividends earned and the average daily balance in the ac-

count for the other period, such as a crediting or dividend period.

The annual percentage yield shall be calculated by using the following formulas ("APY Earned" is used for convenience in the formulas):

A. General formula

APY Earned =
$100[(1 + \text{Dividends earned/Balance})^{(365/\text{Days in period})} - 1]$

"Balance" is the average daily balance in the account for the period.

"Dividends earned" is the actual amount of dividends accrued or paid and credited to the account for the period.

"Days in period" is the actual number of days over which the dividends disclosed on the statement were earned.

EXAMPLES:

(1) If a credit union calculates dividends for the statement period (and uses either the daily balance or the average daily balance method), and the account had a balance of $1,500 for 15 days and a balance of $500 for the remaining 15 days of a 30-day statement period, the average daily balance for the period is $1,000. Assume that $5.25 in dividends was earned during the period. The annual percentage yield earned (using the formula above) is 6.58%:

APY Earned = $100 [(1 + 5.25/1,000)^{(365/30)} - 1]$

APY Earned = 6.58%

(2) Assume a credit union calculates dividends on the average daily balance for the calendar month and provides periodic statements that cover the period from the 16th of one month to the 15th of the next month. The account has a balance of $2,000 September 1 through September 15 and a balance of $1,000 for the remaining 15 days of September. The average daily balance for the month of September is $1,500, which results in $6.50 in dividends earned for the month. The annual percentage yield earned for the month of September would be shown on the periodic statement covering September 16 through October 15. The annual percentage yield earned (using the formula above) is 5.40%:

APY Earned = $100 [(1 + 6.50/1,500)^{(365/30)} - 1]$

APY Earned = 5.40%

(3) Assume a credit union calculates dividends on the average daily balance for a quarter (for example, the calendar months of September through November), and provides monthly periodic statements covering calendar months. The account has a balance of $1,000 throughout the 30 days of September, a balance of $2,000 throughout the 31 days of October, and a balance of $3,000 throughout the 30 days of November. The average daily balance for the quarter is $2,000, which results in $21 in dividends earned for the quarter. The annual percentage yield earned would be shown on the periodic statement for November. The annual percentage yield earned (using the formula above) is 4.28%:

APY Earned = $100 [(1 + 21/2,000)^{(365/91)} - 1]$

APY Earned = 4.28%

B. Special formula for use where periodic statement is sent more often than the period for which dividends are compounded.

Credit unions that use the daily balance method to accrue dividends and that issue periodic statements more often than the period for which dividends are compounded shall use the following special formula:

APY Earned =

$$100 \left[\left(1 + \frac{\text{(Dividends earned/Balance)}}{\text{Days in period (Compounding)}} \right)^{(365/\text{Compounding})} - 1 \right]$$

The following definition applies for use in this formula (all other terms are defined under Part II):

"Compounding" is the number of days in each compounding period.

Assume a credit union calculates dividends for the statement period using the daily balance method, pays a 5.00% dividend rate, compounded annually, and provides periodic statements for each monthly cycle. The account has a daily balance of $1000.00 for a 30-day statement period. The dividend earned of $4.11 for the period, and the annual percentage yield earned (using the special formula above) is 5.00%:

$$\text{APY Earned} = 100 \left[\left(1 + \frac{(\$4.11/1{,}000)}{30} (365) \right)^{(365/365)} - 1 \right] \%$$

Appendix B to Part 707—Model Clauses and Sample Forms

General Note: Appendix B contains model clauses and sample forms intended for optional use by credit unions to aid in compliance with the disclosure requirements of §§ 707.4 (account disclosures), 707.5 (subsequent disclosures), 707.6 (statement disclosures), and 707.8 (advertisements). Section 269(b) of TISA provides that credit unions that use these clauses and forms will be in compliance with TISA's disclosure provisions.

As discussed in the supplementary information to § 707.3(a), this final rule provides for flexibility in designing the format of the disclosures. Credit unions can choose to prepare a single document or brochure that incorporates disclosures for all accounts offered, or to prepare different documents for each type of account. Credit unions may also use inserts to a document, or fill in blanks to show current rates, fees and other terms.

In the model clauses, words in parentheses indicate the type of disclosure a credit union should insert in the space provided (for example, a credit union might insert "July 23, 1995" in the blank for a "(date)" disclosure). Brackets and "/" indicate that a credit union must choose the alternative that best describes its practice (for example, "[daily balance/ average daily balance]"). It should be noted that only in sections B–6 through B–10 of this appendix have specific examples of disclosures been given, with dates and figures. Sections B–1 through B–5, and section B–11 provide only unspecific model clauses or blank forms. The Board felt, as did the FRB in the Appendix A to Regulation DD, that a mix of blank clauses and forms and application of the model clauses to real specific situations would benefit those who must comply with TISA.

Any references to NCUA Rules and Regulations, the *NCUA Standard FCU Bylaws,* or the *NCUA Accounting Manual for FCUs,* are provided for guidance and as a point of reference for credit unions. Citations to these sources does not indicate that their application is required for those credit unions who need not follow them.

B–1 MODEL CLAUSES FOR ACCOUNT DISCLOSURES (§ 707.4(b))

(a) Rate Information (Sec.707.4(b)(1))

(i) *Fixed-Rate Accounts (§ 707.4(b)(1)(i)(A–B))*

1. Interest-bearing Accounts

The interest rate on your deposit account is _____% with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

Note: This provision reflects an accurate statement for an interest-bearing account authorized by state law for state-chartered credit unions. While the definition of the term "interest" permits its substitution for the term "dividends," separate disclosures should be made for interest-bearing accounts. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Given the definition of fixed-rate account in § 707.2(n), credit unions offering fixed-rate accounts must contract to hold rates steady for at least a 30-day period. Thus, if the 30-day option of the last sentence is not chosen, the period chosen must be longer than 30 days.

2. Dividend-bearing Term Share Accounts

The dividend rate on your term share account is _____% with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

Note: This provision reflects an accurate statement for a fixed-rate, dividend-bearing term share account. Interest-bearing term share accounts would use the disclosure in § 1, above. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and

members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Given the definition of fixed-rate account in § 707.2(n), credit unions offering fixed-rate accounts must contract to hold rates steady for at least a 30-day period. Thus, if the 30-day option of the last sentence is not chosen, the period chosen must be longer than 30 days.

3. Other Dividend-bearing Accounts

[As of [the last dividend declaration date/(date)], the dividend rate was _____% with an annual percentage yield (APY) of _____% on your account./or The prospective dividend rate on your account is _____% with a prospective APY of _____% for the current dividend period.] You will be paid this rate for [(time period)/at least 30 calendar days].

or

[As of [the last dividend declaration date/(date)], the dividend rate was _____% with an annual percentage yield (APY) of _____% on your account./or The prospective dividend rate on your account is _____% with an annual percentage yield (APY) of _____% for this dividend period.] This rate will not change unless the credit union notifies you at least 30 calendar days prior to any change.

Note: Credit unions may disclose the dividend rate and annual percentage yield on accounts as of the last dividend declaration date. This necessitates inclusion of a disclosure of the actual calendar date of the last dividend declaration date. Additionally or alternatively (if the last dividend rate could be inaccurate), credit unions may disclose a prospective dividend rate and a prospective annual percentage yield. Such prospective rates and yields must be estimated in good faith, and must be declared at the proper time if it is at all possible to do so. As for the last sentence in these disclosures, this provision reflects a credit union policy to set prospective dividend rates for the next month (or at least 30 days), quarter or other period. Many credit unions, at their mid-monthly board meeting, set prospective dividend rates for the next month beginning on the 1st day of the month and continuing to the last day of the month. These rates must be formalized or ratified at the end of a dividend period. Given the timing of the board meetings, the time to prepare and mail notices and the 30 day period, it will often take credit unions 45 to 60 days to effectively change rates. For these reasons, the Board strongly suggests that credit unions do not offer fixed-rate, dividend-bearing accounts.

(ii) Variable-Rate Accounts (§ 707.4(b)(1)(ii))

1. Interest-bearing Accounts

The interest rate on your deposit account is _____%, with an annual percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] The interest rate and annual percentage yield may change every (time period) based on [(name of index)/the determination of the credit union board of directors]. The interest rate for your account will [never change by more than _____% each (time period)/never be less/more than _____%/never exceed _____% above or fall more than _____% below the initial interest rate].

Note: This disclosure combines the requirements of § 707.4(b)(1)(i) with § 707.4(b)(1)(ii) for interest-bearing accounts. The variable nature of a deposit account usually is based on an external index or is set at the discretion of the board. If another means of rate setting is used, that, instead of the proposed language, must be disclosed. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Rarely would there be limitations on rate changes, but language is provided for this situation in the last sentence. Of course, it is only to be used if it applies to an account.

2. Dividend-bearing Term Share Accounts

The dividend rate on your term share account is _____%, with an annual

percentage yield (APY) of _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] The dividend rate and annual percentage yield may change every (time period) based on [(name of index)/the determination of the credit union board of directors]. The dividend rate for your account will [never change by more than _____% each (time period)/never be less/ more than _____%/never exceed _____% above or fall more than _____% below the initial dividend rate].

Note: This disclosure combines the requirements of § 707.4(b)(1)(i) with § 707.4(b)(1)(ii) for dividend-bearing, variable-rate term share accounts. The variable nature of a deposit account usually is based on an external index or is set at the discretion of the board. If another means of rate setting is used, that, instead of the model language, must be disclosed. Since account opening disclosures may be provided to potential members requesting account information before opening an account, and members opening new accounts, information is provided indicating that the rate may not be current, but that the potential member or member may call the credit union to obtain up-to-date information. When opening a new account, of course, a credit union could provide the contractual rate alone, and delete the sentences in brackets. Rarely would there be limitations on rate changes, but language is provided for this situation in the last sentence. Of course, it is only to be used if it applies to an account.

3. Other Dividend-bearing Accounts

[As of [the last dividend declaration date/ (date)], the dividend rate was _____% with an annual percentage yield (APY) of _____% on your account./or The prospective dividend rate on your account is _____% with an anticipated annual percentage yield (APY) of _____% for the current dividend period.] The dividend rate and annual percentage yield may change every (dividend period) as determined by the credit union board of directors.

Note: This language combines the requirements of § 707.4(b)(1)(i) with § 707.4(b)(1)(ii). Credit unions may disclose the dividend rate and annual percentage yield on accounts as of the last dividend declaration date. This necessitates inclusion of a disclosure of the actual calendar date of the last dividend declaration date or use of the phrase "last dividend declaration date". Additionally or alternatively, credit unions may disclose a prospective dividend rate and a prospective annual percentage yield. Such prospective rates and yields must be estimated in good faith, and must be declared at the proper time if it is at all possible to do so. As for the last sentence in these disclosures, this provision reflects the variable nature of the account. Generally, there is only one variable-rate feature for share accounts: the frequency of dividend period rate changes (e.g., daily, weekly, monthly, quarterly, semi-annually, annually). Normally, there are no contractual limitations on share account earnings (unless imposed by a regulator), nor are earnings based on any internal or external index. If contractual limitations or an index are involved, however, those factors would need to be disclosed (unless a regulator orders otherwise).

(iii) Stepped-Rate Accounts (§ 707.4(b)(1)(i))

1. Interest-bearing Accounts

The initial interest rate on your deposit account is _____%. You will be paid that rate [for (time period)/until (date)]. After that time, the interest rate for your deposit account will be _____% and you will be paid that rate [for (time period)/until (date)]. The annual percentage yield (APY) for your account is _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

2. Dividend-bearing Term Share Accounts

The initial dividend rate on your term share account is _____%. You will be paid that rate [for (time period)/until (date)]. After that time, the dividend rate for your term share account will be _____% and you will be paid that rate [for (time period)/until (date)]. The annual percentage yield (APY) for your account is _____%. [For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were

accurate as of (date). Please call (credit union telephone number) to obtain current rate information.] You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days].

3. Other Dividend-bearing Accounts

[As of [the last dividend declaration date/(date)], the initial dividend rate on your account was _____%./or The prospective dividend rate on your account is _____%.] You will be paid that rate [for (time period)/until (date)]. After that time, the prospective dividend rate for your share account will be _____% and you will be paid such rate [for (time period)/until (date)]. The annual percentage yield (APY) for your account is _____%. You will be paid this rate for [(time period)/at least 30 calendar days].

Note: Stepped-rate accounts are accounts with two or more rates that take effect in succeeding periods. The applicable rates and time periods are known when the account is opened. By nature these are fixed-rate accounts and are usually associated with term share (certificate) accounts. Accordingly, a contract provision (for share accounts) to change rates should be included.

(iv) Tiered-Rate Accounts (§ 707.4(b)(1)(i))

1. Interest-bearing Accounts

Tiering Method A

1* If your [daily balance/average daily balance] is $ _____ or more, the interest rate paid on the entire balance in your account will be _____%, with an annual percentage yield (APY) of _____%.

2* If your [daily balance/average daily balance] is more than $ _____, but less than $ _____, the interest rate paid on the entire balance in your account will be _____%, with an APY of _____%.

3* If your [daily balance/average daily balance] is $ _____ or less, the interest rate paid on the entire balance will be _____% with an APY of _____%.

[For purposes of this disclosure, this is a rate
and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.]

[*Fixed-rate*—You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days]./*Variable-rate*—The interest rate and APY may change every (time period) based on [(name of index)/the determination of the credit union board of directors.]

Note: Tiering Method A pays the stated dividend rate that corresponds to the applicable account balance tier on the full balance in the account. This example contemplates a two-tier system. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the currency of the rate, as is provided in the first set of brackets. A disclosure regarding the fixed-rate or variable-rate nature of the account must be added, as is provided in the last set of brackets.

Tiering Method B

1* A dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____. The annual percentage yield (APY) for this tier will range from _____% to _____%, depending on the balance in the account.

2* A dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____, but less than $_____. The annual percentage yield (APY) for this tier will range from _____% to _____%, depending on the balance in the account.

3* If your [daily balance/average daily balance] is $_____ or less, the dividend rate paid on the entire balance will be _____%, with an annual percentage yield (APY) of _____%.

[For purposes of this disclosure, this is a rate and APY that were offered within the most recent seven calendar days and were accurate as of (date). Please call (credit union telephone number) to obtain current rate information.]

[*Fixed-rate*—You will be paid this rate [for (time period)/until (date)/for at least 30 calendar days]./*Variable-rate*—The interest rate and APY may change every (time period) based on [(name of index)/the determination of the credit union board of directors.]

Note: Tiering Method B pays different stated dividend rates corresponding to applicable deposit tiers, on the applicable balance in each tier of the account. For example, a credit union might pay 3% dividend on account funds of $500 or below, and pay 4% dividend on the portion of the same account that exceeds $500. The example contemplates an account with two tiers, but additional tiers are possible. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the currentness of the rate, as is provided in the first set of brackets.

Tiered-rate accounts can be either fixed-rate or variable-rate accounts. The last sentence offers an option of either fixed-rate or variable-rate disclosure. Thus, the disclosures outlined above will be made in addition to either: (i) disclosure of the period the fixed-rates are in effect or (ii) the variable-rate disclosures. Tiered-rate accounts are also subject to the requirement for disclosure of the balance computation method, *see* paragraph (e) to this appendix.

3. Other Dividend-bearing Accounts

Tiering Method A

1* [As of [the last dividend declaration date/(date)], if your [daily balance/average daily balance] was $_____ or more, the dividend rate paid on the entire balance in your account was _____%, with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] is $_____ or more, a prospective dividend rate of _____% will be paid on the entire balance in your account with a prospective annual percentage yield (APY) of _____% for this dividend period.]

2* [As of [the last dividend declaration date/(date)], if your [daily balance/average daily balance] was more than $_____, but was less than $_____, the dividend rate paid on the entire balance in your account was _____%, with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] is more than $_____, but is less than $_____, a prospective dividend rate of _____% will be paid on the entire balance in your account with a prospective annual percentage yield (APY) of _____% for this dividend period.]

3* [As of the last dividend declaration date/(date)], if your [daily balance/average daily balance] was $_____ or less, the dividend rate paid on the entire balance in your account will be _____% with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] is $_____ or less, the prospective dividend rate of_____% will be paid on the entire balance in your account with an annual percentage yield (APY) of _____% for this dividend period.]

[*Fixed-rate*—You will be paid this rate for [(time period)/at least 30 calendar days]./ *Variable-rate*—The dividend rate and APY may change every (dividend period) as determined by the credit union board of directors.]

Note: Tiering Method A pays the stated dividend rate that corresponds to the applicable deposit tier on the full balance in the account. This example contemplates a two-tier system. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. For tiered-rate accounts, a disclosure may be added about the prospective rate. Note that the prospective rate disclosure options match the required tiered-rate disclosures based on the previous dividend declaration date. A disclosure regarding the fixed-rate or variable-rate nature of the account must be added, as is provided in the last set of brackets.

Tiering Method B

1* [As of [the last dividend declaration date/(date)], a dividend rate of _____% was paid only on the portion of your [daily balance/average daily balance] that was greater than $_____. The annual percentage yield (APY) for this tier ranged from _____% to _____%, depending on the balance in the account./or A prospective dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____ with a prospective annual percentage yield (APY) ranging from _____% to _____%, depending on the balance in the account, for this dividend period.]

2* [As of [the last dividend declaration date/(date)], a dividend rate of _____% was paid only on the portion of your [daily balance/average daily balance] that was greater than $_____ but less than $_____. The annual percentage yield (APY) for this tier ranged from _____% to _____%, depending on the balance in

the account./or A prospective dividend rate of _____% will be paid only on the portion of your [daily balance/average daily balance] that is greater than $_____, but less than $_____] with a prospective annual percentage yield (APY) ranging from _____% to _____%, depending on the balance in the account, for this dividend period.]

3* [As of [the last dividend declaration date/(date)], if your [daily balance/average daily balance] was $_____ or less, the dividend rate paid on the entire balance was _____%, with an annual percentage yield (APY) of _____%./or If your [daily balance/average daily balance] was $_____ or less, the prospective dividend rate paid on the entire balance in your account will be _____% with a prospective annual percentage yield (APY) of _____% for this dividend period.]

Note: Tiering Method B pays different stated dividend rates corresponding to applicable account tiers, on the applicable balance in each tier of the account. For example, a credit union might pay a 3% dividend on account funds of $500 or below, and pay a 4% dividend on the portion of the same account that exceeds $500. The example contemplates an account with two tiers, but additional tiers are possible. The option (1, 2 or 3) most closely matching the terms of the account should be chosen as the appropriate disclosure. Note that the prospective rate disclosure options match the required tiered-rate disclosures based on the previous dividend declaration date.

Tiered-rate accounts can be either fixed-rate or variable-rate accounts. The last sentence offers an option of either fixed-rate or variable-rate disclosures. Thus, the disclosures outlined above must be made in addition to either: (i) disclosure of the period the fixed-rates are in effect or (ii) the variable-rate disclosures. Tiered-rate accounts are also subject to the requirement for disclosure of the balance computation method, *see* paragraph (e) to this appendix.

(b) Nature of Dividends (§ 707.4(b)(8))

Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

Note: The Board of Directors declares dividends based on current income and available earnings of the credit union after providing for the required reserves at the end of the month. The dividend rate and annual percentage yield shown may reflect either the last dividend declaration date on the account or the earnings the credit union anticipates having available for distribution. This disclosure only applies to share and share draft (as opposed to deposit) accounts and should be grouped with the Rate Information to make the disclosures more meaningful. This disclosure also does not apply to term share accounts for reasons discussed in the supplementary information regarding §§ 707.3(e) and 707.4(b)(8).

(c) Compounding and Crediting (§ 707.4(b)(2))

[Dividends/Interest] will be compounded (frequency) and will be credited (frequency).

and, if applicable:

If you close your [share/deposit] account before [dividends/interest] [are/is] paid, you will not receive the accrued [dividends/interest].

and, if applicable (for dividend-bearing accounts):

For this account type, the dividend period is (frequency), for example, the beginning date of the first dividend period of the calendar year is (date) and the ending date of such dividend period is (date). All other dividend periods follow this same pattern of dates. The dividend declaration date follows the ending date of a dividend period, and for the example is (date).

Note: Where the word "(frequency)" appears, time periods must be inserted to coincide with those specified in board resolutions of each credit union's board of directors. A disclosure of dividend period was added to § 707.4(b)(2)(i) in the final rule to assist members in knowing when dividend rate and APY disclosures would be given by a credit union using the optional statement rule of § 707.6(a). The dividend declaration date is important for purposes of § 707.4(a)(2)(ii), request disclosures, § 707.4(b)(2), account opening disclosures, and § 707.8(c)(2), advertising disclosures. The Board believes that this is critical information for dividend-bearing accounts, but that provision by an example (whether of the first dividend period of the year, or of any randomly chosen dividend period) is favorable to providing a list of such dates for the entire year or for a period of years (although these methods would also be permissible). As noted in the supplementary informa-

tion to § 707.2(j), dividend declaration date, the dividend period and actual dividend distribution date may vary. Thus, it is possible for crediting periods and dividend periods not to coincide, though the Board believes that credit unions should make every effort to attempt to coordinate the two periods.

(d) Minimum Balance Requirements (§ 707.4 (b)(3)(i))

(i) *To open the account*

The minimum balance required to open this account is $_____.

or, for first share account at a credit union

The minimum required to open this account is the purchase of a (par value of a share) share in the credit union.

(ii) *To avoid imposition of fees*

You must maintain a minimum daily balance of $_____ in your account to avoid a service fee. If, during any (time period), your account balance falls below the required minimum daily balance, your account will be subject to a service fee of $_____ for that (time period).

or

You must maintain a minimum average daily balance of $_____ in your account to avoid a service fee. If, during any (time period), your average daily balance is below the required minimum, your account will be subject to a service fee of $_____ for that (time period).

(iii) *To obtain the annual percentage yield disclosed*

You must maintain a minimum daily balance of $_____ in your account each day to obtain the disclosed annual percentage yield.

or

You must maintain a minimum average daily balance of $_____ in your account to obtain the disclosed annual percentage yield.

(iv) *Absence of minimum balance requirements*

No minimum balance requirements apply to this account.

(v) *Par value*

The par value of a share in this credit union is $_____.

Note: Where the words "(time period)" appear, time periods should be inserted to coincide with those specified in board resolutions of each credit union's board of directors. As the supplementary information to § 707.4(b)(3)(i) explains, the par value of a share to establish membership is a critical disclosure to be made to potential members of credit unions. The par value disclosure is required by § 707.4(b)(3)(i) as being analogous to a minimum balance account opening requirement.

(e) Balance Computation Method (§ 707.4(b)(3)(ii))

(i) *Daily Balance Method*

[Dividends/Interest] [are/is] calculated by the daily balance method which applies a daily periodic rate to the balance in the account each day.

(ii) *Average Daily Balance Method*

[Dividends/Interest] [are/is] calculated by the average daily balance method which applies a periodic rate to the average daily balance in the account for the period. The average daily balance is calculated by adding the balance in the account for each day of the period and dividing that figure by the number of days in the period.

Note: Any explanation of balance computation method must contain enough information for members to grasp the means by which dividends or interest will be calculated on their accounts. Using a shorthand form, such as "day in/day out" for the daily balance method or "average balance" for the average daily balance method, without more information, is insufficient. In addition, any disclosure based on the equivalency of the two allowable methods, such as stating that the average daily balance method was the same as the daily balance method, is impermissible and misleading.

(f) Accrual of Dividends/Interest on Noncash Deposits (§ 704.4(b)(3)(iii))

[Dividends/Interest] will begin to accrue on the business day you [place/deposit] noncash items (e.g. checks) to your account.

or

[Dividends/Interest] will begin to accrue no later than the business day we receive provisional credit for the [placement/deposit] of noncash items (e.g. checks) to your account.

Note: Accrual information is not included in the explanation of balance computation method required by § 707.4(b)(4)(ii). In addition, the dis-

closures required by TISA do not affect the substantive requirements of the EFAA and Regulation CC. The EFAA and Regulation CC control, and any modifications to them should occasion credit unions to revisit this disclosure with a view to revising it to reflect current law.

(g) Fees and Charges (§ 707.4(b)(4))

The following fees and charges may be assessed against your account:
(service/explanation) $_____
(service/explanation) $_____

Note: Fees and charges may be disclosed in an account disclosure, or separately in a Rate and Fee Schedule (see section B–11 of this appendix). In either event, the disclosure should also specify when the fee will be assessed by using phrases such as "per item," "per month," or "per inquiry."

(h) Transaction Limitations (§ 707.4(b)(5))

The minimum amount you may [withdraw/write a draft for] is $_____.

During any statement period, you may not make more than six withdrawals or transfers to another credit union account of yours or to a third party by means of a preauthorized or automatic transfer or telephonic order or instruction. No more than three of the six transfers may be made by check, draft, debit card, if applicable, or similar order to a third party. If you exceed the transfer limitations set forth above in any statement period, your account will be subject to [closure by the credit union/a fee of $_____].

Note: This paragraph satisfies the requirements of § 707.4(b)(6) with respect to Regulation D limitations on share accounts and money market accounts. These are some of the more common limitations applicable.

The credit union reserves the right to require a member intending to make a withdrawal from any account (except a share draft account) to give written notice of such intent not less than seven days and up to 60 days before such withdrawal.

Note: This disclosure is limted to federal credit unions with Bylaws containing this limitation. See Standard Federal Credit Union Bylaws, Art. III, § 5(a). Similar disclosures are required of any state-chartered credit unions having similar limitations in their bylaws, or under state law. This limitation does not directly relate to the "number" or "amount" of transactions, and accordingly, may not be necessary under § 707.4(b)(5), but would, if applicable, be required by § 707.3(b).

(i) Disclosures related to term share accounts (§ 707.4(b)(6))

(i) *Time requirements*

Your account will mature on (date).

or

Your account will mature after (time period).

(ii) *Early withdrawal penalties*

We [will/may] impose a penalty if you withdraw [any/all] of the [funds/principal] in your account before the maturity date. The penalty will equal [_____ days'/weeks'/months'] [dividends/interest] on your account.

or

We [will/may] impose a penalty of $_____ if you withdraw [any/all] of the [funds/principal] before the maturity date.

If you withdraw some of your funds before maturity, the [dividend/interest] rate for the remaining funds in your account will be _____%, with an annual percentage yield of _____%.

Note: In most cases, the dividend rate and annual percentage yield on the funds remaining in the account after early withdrawal are the same as before the withdrawal. Accordingly, the disclosure of dividend rate and annual percentage yield after withdrawal is required only if the dividend rate and APY will change.

(iii) *Withdrawal of dividends/interest prior to maturity*

The annual percentage yield is based on an assumption that [dividends/interest] will remain in the account until maturity. A withdrawal will reduce earnings.

Note: This disclosure may be used if the credit union compounds dividends/interest and allows withdrawal of accrued dividends/interest before maturity. This disclosure alerts members that the annual percentage yield is based on an assumption that the dividends/interest remain on deposit until maturity.

(iv) *Renewal policies*

1. *Automatically renewable term share accounts*

Your term share account will automatically renew at maturity. You will have a grace period of _____ [calendar/business] days

after the maturity date to withdraw the funds in the account without being charged an early withdrawal penalty.

or

Your term share account will automatically renew at maturity. There is no grace period following the maturity of this account.

2. *Non-automatically renewable term share accounts*

This account will not renew automatically at maturity. If you do not renew the account, your account will [continue to earn/ no longer earn] [dividends/interest] after the maturity date.

Note: These disclosures should agree with the necessary prematurity notices for term share accounts in B–3 of this appendix.

(j) Bonuses (§ 704.4(b)(7))

You will [be paid/receive] [$_____/ (description of item)] as a bonus [when you open the account/on (date)].

You must maintain a minimum [daily balance/ average daily balance] of $_____ to obtain the bonus.

To earn the bonus, [$_____/your entire principal] must remain on deposit [for (time period)/until (date)].

Note: These disclosures follow the requirements of § 707.4(b)(7) and should be used as applicable. Further information may also be added, especially if it clarifies the conditions and timing of receiving the bonus, or better informs the member about the bonus.

B–2 MODEL CLAUSES FOR CHANGES IN TERMS (§ 707.5(a))

On (date), the (type of fee) will increase to $_____. On (date), the [dividend/interest] rate on your account will decrease to _____%, with an annual percentage yield (APY) of _____%.

On (date), the [minimum daily balance/ average daily balance] required to avoid imposition of a fee will increase to $_____.

Note: These examples apply to the more common changes necessitating a changes in terms notice. However, any change, amendment or modification reducing the APY or adversely affecting the members holding such accounts must be disclosed. For such changes not contemplated by the model clauses, the Board recommends the use of as simple language as possible to convey the change, along with cross-referencing to the particular sections or paragraph numbers of the account opening disclosures, when to do so will assist members in reviewing and understanding the change.

B–3 MODEL CLAUSES FOR PRE-MATURITY NOTICES FOR TERM SHARE ACCOUNTS (§ 707.5(b–d))

(a) *Maturity date*

Your term share account will mature on _____.

(b) *Nonrenewal*

Unless your term share account is renewed, it will not accrue further [dividends/ interest] after the maturity date.

(c) *Rate information*

The [dividend/interest] rate and annual percentage yield that will apply to your term share account if it is renewed have not yet been determined. That information will be available on _____. After that date, you may call the credit union during regular business hours at (telephone number) to find out the [dividend/interest] rate and annual percentage yield (APY) that will apply to your term share account if it is renewed.

Note: Pre-maturity notices should follow the requirements of § 707.5(b–d) as closely as possible. Care should be taken to explain any grace periods used. See discussion of use of alternative timing in supplementary information to § 707.2(o) and § 707.5(b–d).

B–4 SAMPLE FORM (SIGNATURE CARD/ APPLICATION FOR MEMBERSHIP)

SIGNATURE CARD/APPLICATION FOR MEMBERSHIP

ACCOUNT NUMBER _____

(last name) (first name) (middle name)

(street address) (apartment no.)

(city) (state) (zip code)

(home telephone no.) (business telephone no.)

(Social Security # or TIN) (date of birth)

(mother's maiden name) (employer, occupation)

I hereby make application for membership in and agree to conform to the Bylaws, as amended, of _____ Credit Union (the "Credit Union"). I certify that: I am within the field of membership of this Credit Union; the information provided on this application is true and correct; and my signature on this card applies to all accounts under my name at this Credit Union. I also agree to be bound to the terms and conditions of any account that I have in the Credit Union now or in the future.

_____
(signature of applicant)

This application approved _____ (date) by the (Check one)
( ) Board ( ) Exec. Committee ( ) Membership Officer

Signed: _____
(Secretary; Exec. Cmte. Member, or Membership Officer)

Note: This form is modeled on NCUA Form FCU 150, Application for Membership, as discussed in the Accounting Manual for FCUs, §§ 5030.1, 5150.3. It is noted that other information can also be requested on the signature card, as long as it is in accordance with federal and state laws. For example, information identifying the member, such as a state driver's license number, could be added. The types of accounts that the signature applies to could be specified. Furthermore, the Board notes that this card contains much identification information that may not be necessary for all credit unions; common sense should guide credit union boards of directors in designing their applications for membership/signature cards. However, the Board believes that the information solicited on this form is reasonable and prudent for many credit unions. Payable on death designations, joint account language required under state law, life savings beneficiary designations, and other like variations and designations may be added to the card if so desired. The proposed signature card/ application for membership form contained taxpayer certification language. One commenter noted that the IRS may always change its requirements in this area, which are beyond the authority of the Board. Therefore, the Board has deleted reference to the IRS taxpayer certification required by 26 USC 3406, but notes that such certification must be made in accordance with applicable law and IRS rules. The information may be included on the front and back of a standard size signature card, or on the front of a large size signature card. However, no account terms may be included on a signature card unless a copy of the signature card is provided to the member at the time of account opening. The Board recommends that credit unions refrain from this practice, and instead use standard account disclosures. One reason for this is that if laws, regulations or credit union policies change, discrepancies may result between them and the earlier signature card terms. Given the longevity of credit union membership, signature cards may well be in use for up to or over a century. In addition, as signature cards are relatively small, they probably will not contain enough space to make all desired and required disclosures. Fragmentation of terms, some on signature cards, some on separate disclosures, could easily lead to member confusion. As terms are usually construed against the drafter, credit unions should be very careful in their use of account terms and conditions varying from those provided as model clauses and sample forms in this appendix.

B–5 SAMPLE FORM (TERM SHARE [CERTIFICATE] ACCOUNT)

TERM SHARE (CERTIFICATE) ACCOUNT

_____ _____
Date Issued Account Number

_____ _____
Certificate Number Social Security Number

This is to certify that (name(s)) _____ [is/are] the owner(s) of a term share certificate account in the _____ Credit Union (the "Credit Union") in the amount of _____ Dollars ($_____). This term share certificate account may be redeemed on (maturity date) _____ only upon presentation of the certificate to the Credit Union. The dividend rate of this certificate account is _____% with an annual percentage yield of _____%. The annual percentage yield and dividend rate assume that dividends are to be [check one] ( ) added to principal/ ( ) paid to regular share account number _____/( ) mailed to owner(s). This account is subject to all terms and conditions stated in the Term Share Certificate Account Disclosures, as they may be amended from time to time, and incorporates the same by reference into this agreement.

_____
Authorized signature

_____
Authorized signature

Note: This form is modeled on NCUA Form FCU 107SCP, Credit Union Share Certificate, as discussed in the Accounting Manual for FCUs, §§ 5030.1, 5150.6. It is simplified to reflect the term share (certificate) account agreement, the parties involved, the maturity term and the annual percentage yield and dividend rate. All other terms are incorporated by reference. This should allow the credit union maximum flexibility in fashioning certificate, and other term share account, products. If a credit union so desired, other terms and conditions could be incorporated into the term share certificate itself, as long as a copy is presented to the member at the account opening. Care should also be taken to ensure that the term share certificate format addresses any necessary state law concerns. As the FRB's Regulation D on reserve requirements permits all term share accounts to be represented by a transferable or nontransferable, or a negotiable or nonnegotiable, certificate, instrument, passbook, statement or otherwise, and still be considered a "time deposit", the Board has made no entry on this sample form regarding such terms, leaving the decision instead to each credit union's board of directors. 12 CFR 202.4(c)(2).

B–6 SAMPLE FORM (REGULAR SHARE ACCOUNT DISCLOSURES)

REGULAR SHARE ACCOUNT DISCLOSURES

1. *Rate information.* As of April 1, 1995, the dividend rate was 5.00% and the annual percentage yield (APY) was 5.13% on your regular share account. In addition, the credit union estimates a prospective dividend rate of 5.25% and a prospective APY of 5.39% on your share account for this dividend period. The divident rate and annual percentage yield may change every quarter as determined by the credit union board of directors.

2. *Compounding and crediting.* Dividends will be compounded daily and will be credited quarterly. For this account type, the dividend period is quarterly, for example, the beginning date of the first dividend period of the calendar year is January 1 and the ending date of such dividend period is March 31. All other dividend periods follow this same pattern of dates. The dividend declaration date follows the ending date of a dividend period, and for the example is April 1. If you close your regular share account before dividends are credited, you will not receive accrued dividends.

3. *Minimum balance requirements.* The minimum balance to open this account is the purchase of a $5 share in the Credit Union. You must maintain a minimum daily balance of $500 in your account to avoid a service fee. If, during any day during a quarter, your account balance falls below the required minimum daily balance, your account will be subject to a service fee of $5 for that quarter.

4. *Balance computation method.* Dividends are calculated by the daily balance method which applies a daily periodic rate to the principal in your account each day.

5. *Accrual of dividends.* Dividends will begin to accrue on the business day you deposit noncash items (e.g., checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Dormant account fee .	$10.00 per month
d. Wire transfers	$8.00 per transfer
e. Minimum balance service fee.	$5.00 per quarter
f. Share transfer	$1.00 per transfer
g. Excessive share	$1.00 per item withdrawals

7. *Transaction limitations.* During any statement period, you may not make more than six withdrawals or transfers to another credit union account of yours or to a third party by means of a preauthorized or automatic transfer or telephonic order or instruction. No more than three of the six transfers may be made by check, draft, debit card, if applicable, or similar order to a third party. If you exceed the transfer limitations set forth above in any statement period, your account will be subject to closure by the credit union or to a fee of $1.00 per item.

8. *Nature of dividends.* Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

9. *Bylaw Requirements.* A member who fails to complete payment of one share within _____ of his admission to membership, or within _____ from the increase in the par value in shares, or a member who reduces his share balance below the par value of one share and does not increase the balance to at least the par value of one share within _____ of the reduction may be terminated from membership at the end of a dividend period. [All blanks should be filled with time chosen by credit union board of directors, but must be at least 6 months.] Shares may be transferred only from one member to another, by written instrument in such form as the Credit Union may prescribe. The Credit Union reserves the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the whole or any part of the amounts so paid in by them. No member may withdraw shareholdings that are pledged as required on security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the Credit Union. No member may withdraw any shareholdings below the amount of his/her primary or contingent liability to the Credit Union if he/she is delinquent as a borrower, or if borrowers for whom he/she is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or loan officer.

10. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $5. The dividend period of the Credit Union is quarterly.

11. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

12. *Other Terms and Conditions.* [In this item, which may be titled or subdivided in any manner by each credit union, NCUA suggests that the following issues be covered or handled: statutory lien or setoff; expenses (garnishments and bankruptcy orders and holds on account); joint ownership accounts; trust accounts; payable-on-death accounts; retirement accounts; Uniform Transfer to Minor Act accounts; sole proprietorship accounts; escrow and custodial accounts; corporation accounts; not-for-profit corporation accounts; voluntary association accounts; partnership accounts; public unit accounts; powers of attorney (guardianship orders); tax disclosures and certifications; Uniform Commercial Code variances; amendments; reliance on signature card; change of address; incorporations of other documents by reference, such as expedited funds availability policies, service charges schedules or electronic banking disclosures; ability to suspend services; and operational matters (stop payment orders—verbal and written, satisfactory identification, refusal of deposits not in proper form, wire transfers, stale check deposits, availability of periodic statements or passbook feature.)]

Note: This form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7. The disclosures are for a variable-rate, daily balance method dividend calculation regular share account in an FCU with a $500 minimum balance to avoid service fees. For the example, the account was opened on May 1, 1995. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures will reflect the prospective dividend rate for a given dividend period. Item nos. 1–8 reflect standard TISA and part 707 disclosures discussed in sections B–1 through B–3 of this Appendix. Note that if the credit union limits the maximum amount of shares which may be held by one member under NCUA Standard FCU Bylaws, Art. III, § 2, that this should be stated in item no. 7, transaction limitations. Item no. 9 reflects various terms provided in Art. III, §§ 3–6 of the NCUA Standard FCU Bylaws. If this were a passbook account, then the requirements of Art. IV, Receipting for Money—Passbooks, in the NCUA Standard FCU Bylaws would also be included in item no. 9. Item no. 10 reflects the par value amount of regular shares in a federal credit union, pursuant to section 117 of the FCU Act, 12 USC 117, and Art. XIV, § 3 of the NCUA Standard FCU Bylaws. It also states the dividend period of the credit union, which is set by the board of directors. Item no. 11 addresses the requirements of 12 CFR part 740. Nonfederally insured credit unions (NICUs) would be expected to disclose information required by section 151 of the Federal Deposit Insurance Corporation Improvement Act of 1991. 12 USC

1831t. By December 19, 1992, all NICUs were required to include conspicuously on all periodic statements of account, signature cards, passbooks, share certificates and other similar instruments of deposit and in all advertising a notice that the credit union is not federally insured. Additional disclosures will be required of NICUs by June 19, 1994. Item no. 12 is inserted to ensure that credit unions add other account terms and conditions not covered by the proposed regulation. These sorts of terms are contemplated by proposed § 707.3(b), requiring that the disclosures reflect the terms of the legal obligation between the member and the credit union. This list is not meant to be exhaustive, but to give a general idea of other topics often covered in share account contracts. Item no. 12 is not expressly required by either TISA or part 707, but any of these terms that are disclosed must be accurate and not misleading. Also the Board strongly recommends that such terms are included in account opening disclosures to inform the membership and to clearly set forth the legal relationship between the members and their credit union.

B–7 SAMPLE FORM (SHARE DRAFT ACCOUNT DISCLOSURES)

SHARE DRAFT ACCOUNT DISCLOSURES

1. *Rate information.* As of January 1, 1995, the dividend rate was 3.00% and the annual percentage yield (APY) was 3.04% on your share account. In addition, the prospective dividend rate on your account is 3.15% with a prospective annual percentage yield (APY) of 3.20% for the current dividend period. The dividend rate and APY may change every dividend period as determined by the credit union board of directors.

2. *Compounding and crediting.* Dividends will be compounded monthly and will be credited monthly. For this account type, the dividend period is monthly, for example, the beginning date of the first dividend period of the calendar year is January 1 and the ending date of such dividend period is January 31. All other dividend periods follow this same pattern of dates. The dividend declaration date follows the ending date of a dividend period, and for the example above is February 1. If you close your share draft account before dividends are credited, you will not receive accrued dividends.

3. *No minimum balance requirements apply to this account.*

4. *Balance computation method.* Dividends are calculated by the average daily balance method which applies a periodic rate to the average daily balance in the account for the period. The average daily balance is calculated by adding the balance in the account for each day of the period and dividing that figure by the number of days in the period.

5. *Accrual of dividends.* Dividends will begin to accrue no later than the business day we receive provisional credit for the placement of noncash items (e.g. checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Dormant account fee .	$10.00 per month
d. Wire transfers	$8.00 per transfer
e. Overdrafts/Returned Items.	$5.00 per draft
f. Share transfer	$1.00 per transfer
g. Excessive share withdrawal.	$1.00 per item
h. Certified checks	$5.00 per check
i. Stop Payment Order ..	$5.00 per order
j. Check Printing Fee	$12.00 per 200 checks (varies depending on style of check ordered)

7. *No transaction limitations apply to this account.*

8. *Nature of dividends.* Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

9. *Bylaw Requirements.* A member who fails to complete payment of one share within _____ of his admission to membership, or within _____ from the increase in the par value in shares, or a member who reduces his share balance below the par value of one share and does not increase the balance to at least the par value of one share within _____ of the reduction may be terminated from membership at the end of a dividend period. [All blanks should be filled with time chosen by credit union board of directors, but must be at least 6 months.] Shares may be transferred only from one member to another, by written instrument in such form as the Credit Union may prescribe. The Credit Union reserves the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the

whole or any part of the amounts so paid in by them. Shares paid in under an accumulated payroll deduction plan may not be withdrawn until credited to a member's account. No member may withdraw shareholdings that are pledged as required on security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the Credit Union. No member may withdraw any shareholdings below the amount of his/her primary or contingent liability to the Credit Union if he/she is delinquent as a borrower, or if borrowers for whom he/she is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or loan officer.

10. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $5. The dividend period of the Credit Union is monthly, beginning on the first of a month and ending on the last day of the month.

11. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

12. *Other Terms and Conditions.* [See section B–6, item 12, of this appendix].

Note: This form is modeled on the share account disclosures in the Accounting Manual for FCUs, §5150.7. The disclosures are for a variable-rate, average daily balance method dividend calculation share draft account in an FCU with no minimum balance requirement. For purposes of this example, the account was opened on January 15, 1995. The Credit Union has monthly dividend periods. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures will reflect the prospective dividend rate for a given dividend period. The disclosures are very similar to the ones in section B–6 of Appendix B, except for the rollback and par value disclosures, which have been removed from the final rule and appendices.

B–8 SAMPLE FORM (MONEY MARKET SHARE ACCOUNT DISCLOSURES)

MONEY MARKET SHARE ACCOUNT DISCLOSURES

1. *Rate information.* As of January 1, 1995, if your average daily balance was $500 or more, the dividend rate paid on the entire balance in your account was 4.75%, with an annual percentage yield (APY) of 4.85%. If your average daily balance is $500 or more, a prospective dividend rate of 4.95% will be paid on the entire balance in your account with a prospective APY of 5.00% for this dividend period on your account. The dividend rate and APY may change every dividend period as determined by the credit union board of directors.

2. *Compounding and crediting.* Dividends will be compounded monthly and will be credited quarterly. If you close your share money market account before dividends are credited, you will not receive accrued dividends.

3. *Minimum balance requirements.* The minimum balance required to open this account is $500. You must maintain a minimum daily balance of $500 in your account to avoid a service fee. If, during any (time period), your account falls below the required minimum daily balance, your account will be subject to a service fee of $5 for that (time period).

4. *Balance computation method.* Dividends are calculated by the average daily balance method which applies a periodic rate to the average daily balance in your account for the period. The average daily balance is calculated by adding the principal in the account for each day of the period and dividing that figure by the number of days in the period.

5. *Accrual of dividends.* Dividends will begin to accrue on the business day you deposit noncash items (e.g., checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Dormant accountee	$10.00 per month
d. Wire transfers	$8.00 per transfer
e. Minimum balance service fee.	$5.00 per time period
f. Share transfer	$1.00 per transfer
g. Excessive share withdrawals.	$1.00 per item
h. Certified checks	$5.00 per check
i. Stop Payment Order ..	$5.00 per order
j. Check Printing Fee	$12.00 per 200 checks (varies depending on style of check ordered)

7. *Transaction limitations.* During any statement period, you may not make more than six withdrawals or transfers to another credit union account of yours or to a third party by means of a preauthorized or automatic transfer or telephonic order or instruction. No more than three of the six transfers may be made by check, draft, debit card, if applicable, or similar order to a third party. If you exceed the transfer limitations set forth above in any statement period, your account will be subject to closure by the credit union or to a fee of $1.00 per item.

8. *Nature of dividends.* Dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.

9. *Bylaw Requirements.* [This section should reflect any requirements concerning share accounts in the FISCU's bylaws or charter.]

10. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $50. The dividend period of the Credit Union is monthly, beginning on the first of a month and ending on the last day of the month.

11. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

12. *Other Terms and Conditions.* [See section B–6, item 12, of this appendix.]

Note: This form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7 and on the share draft account disclosures in section B–7 of this appendix. The disclosures are for a variable-rate, tiered-rate (method A, option 1), average daily balance method dividend calculation, money market share account in a FISCU with a $500 minimum balance to open the account and to avoid service fees. For purposes of this example, the account was opened on January 29, 1995. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures will reflect the prospective dividend rate for a given dividend period. Note that the contents of Item 9, Bylaw requirements, must be tailored to the specific bylaws of a FISCU or NICU. Also note the high par value amount in Item 10.

B–9 SAMPLE FORM (TERM SHARE [CERTIFICATE] ACCOUNT DISCLOSURES)

TERM SHARE (CERTIFICATE) ACCOUNT DISCLOSURES

1. *Rate information.* [Repeat rates disclosed on face of term share certificate, see B–5, Sample Form (Term Share (Certificate) Account).]

2. *Compounding and crediting.* Dividends will be compounded monthly and will be credited annually. If you close your certificate account before dividends are credited, you will not receive accrued dividends.

3. *Minimum balance requirements.* The minimum balance required to open this account is $500.

4. *Balance computation method.* Dividends are calculated by the daily balance method, which applies a daily periodic rate to the principal in your account each day.

5. *Accrual of dividends.* Dividends will begin to accrue on the business day you deposit noncash items (e.g., checks) to your account.

6. *Fees and charges.* The following fees and charges may be assessed against your account.

a. Statement copies	$5.00 per statement
b. Account inquiries	$3.00 per inquiry
c. Share transfer	$1.00 per transfer

7. *Transaction limitations.* After the account is opened, you may not make deposits into the account until the maturity date stated on the certificate.

8. *Maturity date.* Your account will mature on January 1, 1996.

9. *Early withdrawal penalties.* We may impose a penalty if you withdraw any of the funds before the maturity date. The penalty will equal three months' dividends on your deposit.

10. *Renewal policies.* Your certificate account will automatically renew at maturity. You will have a grace period of 10 business days after the maturity date to withdraw the funds in the account without being charged an early withdrawal penalty.

11. *Bonus.* You will receive a new (insert brand name) toaster-oven as a bonus when you open the account after December 31, 1994, and before June 30, 1995. You must maintain your entire principal on deposit until the maturity date of your certificate account to obtain the bonus.

12. **[RESERVED]**

13. *Bylaw Requirements.* [This section should reflect any requirements concerning share accounts in the FISCU's bylaws or charter.]

14. *Par value of shares; Dividend period.* The par value of a regular share in this Credit Union is $25. The dividend period of the Credit Union on this type of account is annual, beginning on the date the account is opened, and ending on the stated maturity date, unless renewed.

15. *National Credit Union Share Insurance Fund.* Member accounts in this Credit Union are federally insured by the National Credit Union Share Insurance Fund.

16. *Other Terms and Conditions.* [See section B–6, item 12, of this appendix.]

Note: Even though this disclosure is for an account at a FISCU, this form is modeled on the share account disclosures in the Accounting Manual for FCUs, § 5150.7 and upon the regular share account disclosures in section B–6 of this appendix. The disclosures are for a fixed-rate, daily balance method dividend calculation, automatically renewing term share certificate account in a FISCU with a $500 minimum balance to open the account and a ten day grace period. For the example, the account is opened on January 1, 1995 and matures on January 1, 1996. Other terms are self-explanatory. The dividend rate paid and annual percentage yield disclosures reflect the contracted, prospective dividend rate for a given dividend period. Note the special disclosures for term share certificate accounts, items nos. 8–10. Note also the bonus disclosure, item no. 11.

B–10 SAMPLE FORM (PERIODIC STATEMENT)

PERIODIC STATEMENT

_____ _____
Member Name Account Number

[Transaction account activity by date]

[Average daily balance of $1,500 for the month, daily compounding]

Your account earned $6.72, with an annual percentage yield earned of 5.40%, for the statement period from May 1 through and including May 31. In addition, your account earned $15 in extraordinary dividends for this period. Any fees assessed against your account are shown in the body of the periodic statement and are identified by the code at the bottom margin of this statement.

Service charge codes

SC-1 Stop Payment Order Fee
SC-2 Statement Copy Fee
SC-3 Draft Return Fee
SC-4 Transfer from Shares
SC-5 Microfilm Copy
SC-6 Share Draft Printing Fee
SC-7 Dormant Account Fee
SC-8 Wire Transfer Fee
SC-9 Excessive Share Withdrawal Fee
SC-10 _____

Other transactions

D=Dividends
EC=Error Correction
OR=Overdraft Returned
OL=Overdraft Loan
OS=Overdraft Share Transfer

Note: This form is modeled on the share draft statement of account, Form FCU 107G-SD, in the Accounting Manual for FCUs, § 5150.4. All information is self-explanatory. Codes of transactions are not required, but are a common credit union practice. The information regarding fees could also be included on the line of the periodic statement showing when the fees were debited from the account. Alternatively, a credit union could show all fees debited against the account for the statement period in a special area of the periodic statement. Clarity to the member of the required information—annual percentage yield earned; amount of dividends; fees imposed and length of period—is the important goal. An additional disclosure regarding the dollar value of any extraordinary dividends earned must be added to those statements showing the payment of such extraordinary dividends to the member.

B–11 SAMPLE FORM (RATE AND FEE SCHEDULE)

RATE AND FEE SCHEDULE

This Rate and Fee Schedule for all Accounts sets forth certain conditions, rates, fees and charges applicable to your regular share, share draft, and money market accounts at the _____ Federal Credit Union as of _____ [insert date of delivery to member]. This schedule is incorporated as part of your account agreement with the _____ Federal Credit Union.

REGULAR SHARE

Dividend Rate as of Last Dividend Declaration Date _____%

Annual Percentage Yield as of Last Dividend Declaration Date _____%
Prospective Dividend Rate _____%
Prospective Annual Percentage Yield _____%
Dividends Compounded [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]
Dividends Credited—At close of a dividend period
Dividend Period [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]
Minimum Opening Deposit $5.00 par value share
Minimum Monthly Balance [None, $ amount]

SHARE DRAFT

Dividend Rate as of Last Dividend Declaration Date _____%
Annual Percentage Yield as of Last Dividend Declaration Date _____%
Prospective Dividend Rate _____%
Prospective Annual Percentage Yield _____%
Dividends Compounded [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]
Dividends Credited—At close of a dividend period
Dividend Period [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]
Minimum Opening Deposit [None, $ amount]
Minimum Monthly Balance [None, $ amount]

MONEY MARKET

Dividend Rate as of Last Dividend Declaration Date _____%
Annual Percentage Yield as of Last Dividend Declaration Date _____%
Prospective Dividend Rate _____%
Prospective Annual Percentage Yield _____%
Dividends Compounded [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]
Dividends Credited— At close of a dividend period
Dividend Period [Annually, Semiannually, Quarterly, Monthly, Weekly, Daily]
Minimum Opening Deposit [None, $ amount]
Minimum Monthly Balance [None, $ amount]

The following fees may be assessed in connection with your accounts:

Fees Applicable to All Accounts:	
Returned item fee	$____.00 per item
Account reconciliation fee.	$____.00 per hour
Statement copies fee	$____.00 per statement
Certified draft fee	$____.00 per draft
Wire	$____.00 per transfer
Account inquiry fee	$____.00 per inquiry
Dormant account fee	$____.00 per month
Minimum balance service fee.	$____.00 per day
Share transfer fee	$____.00 per Transfer
Excessive share withdrawal transfer fee.	$____.00 per item
Share Draft Account Fees:	
Monthly service fee	$____.00 per month
Overdraft transfers fee .	$____.00 per overdraft
Drafts returned insufficient funds fee.	$____.00 per draft
Stop payment order fee .	$____.00 per order
Draft copy fee	$____.00 per copy
Check printing fee	$____.00 per 200 drafts
Money Market Share Account Fees:	
Monthly service fee	$____.00 per month
Check printing fee	$____.00 per 200 drafts

Note: This illustration is for use of an FCU. The information provided on a Rate and Fee Schedule can be presented in any format. To ensure that it is a part of the account agreement, if used, it should be incorporated by reference into the appropriate share account disclosures. The figures used are illustrative only, except for the overdraft transfer fee of $1.00 per overdraft and the excessive share transfer fee of $1.00 per item, which are set in the NCUA Standard FCU Bylaws, Art. III, § 4 and § 5(f), respectively.

Appendix C—Official Staff Interpretations

Introduction

1. *Official status.* This commentary is the means by which the staff of the Office of General Counsel of the National Credit Union Administration issues official staff interpretations of Part 707 of the NCUA Rules and Regulations. Good faith compliance with this commentary affords protection from liability under section 271(f) of the Truth in Savings Act (TISA), 12 U.S.C. § 4311.

§ 707.1—Authority, purpose, coverage, and effect on state laws.

(c) Coverage

1. *Foreign applicability.* Part 707 applies to all credit unions that offer share and deposit accounts to residents (including resident aliens) of any state as defined in 707.2(v) and that offer accounts insurable by the National Credit Union Share Insurance Fund (NCUSIF) whether or not such accounts are insured by the NCUSIF. Corporate credit unions designated as such by NCUA under 12 CFR § 704.2 (definition of "corporate credit union") are exempt from part 707.

2. *Persons who advertise accounts.* Persons who advertise accounts are subject to the advertising rules. This includes agent and agented accounts, such as a member who subdivides interests in a jumbo term share certificate account for sale to other parties or among members who form a certificate account investment club. For example, if an agent places an advertisement that offers members an interest in an account at a credit union, the advertising rules apply to the advertisement, whether the account is held by the agent or directly by the member.

3. *Nonautomated credit unions.* Nonautomated credit unions with an asset size of $2 million or less, after subtracting any nonmember deposits, are exempt from TISA and part 707. NCUA defines a "nonautomated credit union" as a credit union without sufficient data processing capability and capacity to establish, operate and maintain a share and loan software system to timely and accurately process all account transactions of all members. The nonautomated credit union exemption is available to all credit unions meeting the asset size and automation standards of this comment, including newly chartered credit unions. If any of the credit unions eligible for this exemption grow to have more than $2 million in assets as of December 31 of any year, the NCUA Board will require such credit unions to comply with TISA and part 707 on January 1 of one year after such credit union loses its exemption eligibility. Similarly, if a credit union becomes sufficiently automated to operate a complete share and loan system, such credit union will be entitled to the same compliance phase-in period.

(d) Effect on state laws

1. *Preemption of state laws/Inconsistent requirements.* State law requirements that are inconsistent with the requirements of TISA and part 707 are preempted to the extent of the inconsistency. A state law is inconsistent if it requires a credit union to make disclosures or take actions that contradict the requirements of the federal law. A state law is also contradictory if it requires the use of the same term to represent a different amount or a different meaning than the federal law, requires the use of a term different from that required in the federal law to describe the same item, or permits a method of calculating dividends or interest on an account different from that required in the federal law.

2. *Preemption determinations.* A credit union, state, or other interested party may request the Board to determine whether a state law requirement is inconsistent with the federal requirements. A request for a determination should be addressed to NCUA's Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314. Written preemption requests should cite (or include a copy of) the allegedly inconsistent state law, demonstrate the inconsistency with TISA and part 707 and the burden on credit unions, and formally request a preemption determination. The Office of General Counsel may provide other interested parties, particularly affected states, an informal opportunity to comment on any request for a preemption determination, unless it finds that such notice and opportunity for comment would be impracticable, unnecessary, or contrary to the public interest. NCUA will publicize any preemption determinations using any means readily at its disposal.

3. *Effect of preemption determinations.* After the Board, through its Office of General Counsel, determines that a state law is inconsistent,

a credit union may not make disclosures using the inconsistent term or take actions relying on the inconsistent law.

4. *Reversal of determination.* The Board reserves the right to reverse a determination for any reason bearing on the coverage or effect of state or federal law.

§ 707.2—Definitions.

(a) Account

1. *Covered accounts.* Examples of accounts subject to the regulation are:

i. Dividend-bearing and interest-bearing accounts.

ii. Non-dividend-bearing and non-interest-bearing accounts.

iii. Accounts opened as a condition of obtaining a credit card.

iv. Escrow accounts with a consumer purpose, such as an account established by a member to escrow rental payments, pending resolution of a dispute with the member's landlord.

v. Accounts held by a parent or custodian for a minor under a state's Uniform Gift to Minors Act (or Uniform Transfers to Minors Act).

vi. Individual retirement accounts (IRAs) and simplified employee pension (SEP) accounts.

vii. Payable-on-Death (POD) or "Totten trust" accounts.

2. *Other accounts.* Examples of accounts not subject to the regulation are:

i. Mortgage escrow accounts for collecting taxes and property insurance premiums.

ii. Accounts established to make periodic disbursements on construction loans.

iii. Trust accounts opened by a trustee pursuant to a formal written trust agreement (not merely declarations of trust on a signature card such as a "Totten trust," or an IRA or SEP account).

iv. Accounts opened by an executor in the name of a decedent's estate.

v. Accounts of individuals operating businesses as sole proprietors.

vi. Certificates of indebtedness. Some credit unions borrow funds from their members through a certificate of indebtedness that sets forth the terms and conditions of the repayment of the borrowing, such as federal credit unions do through 12 CFR § 701.38. Such an account does not represent an account in a credit union and is not covered by part 707.

vii. Unincorporated nonbusiness association accounts.

3. *Other investments.* The term "account" does not apply to these products. Examples of products not covered are:

i. Government securities.

ii. Mutual funds.

iii. Annuities.

iv. Securities or obligations of a credit union.

v. Contractual arrangements such as repurchase agreements, interest rate swaps, and bankers acceptances.

vi. Purchases of U.S. Savings Bonds through a credit union.

vii. Services offered through a group purchasing plan or a credit union service organization (CUSO).

4. *Options.* All dividend-bearing and interest-bearing accounts are either fixed-rate or variable-rate accounts.

5. *Use of synonyms.* Generally, it is not the purpose of part 707 to prohibit specific descriptive terms for accounts. For example, credit unions can use adjectives and trade names to describe accounts such as "Best Share Draft Account," or "Ultra Money Market Share Account." Synonyms for share, share draft, money market share, and term share accounts may be used to describe various types of credit union share and deposit accounts as long as the synonym is accurate and not misleading and, for account disclosures, is used in conjunction with the correct legal term. For example, the following synonyms may be used:

i. The term "checking account" may be used to describe share draft accounts.

ii. The term "money market account" may be used to describe money market share accounts.

iii. The term "savings account" may be used to describe regular share and share accounts.

iv. The terms "share certificate," "certificate account," or "certificate" may be used to describe share certificates and other dividend-bearing term share accounts.

v. However, under no circumstances may a credit union describe a share account as a deposit account, or vice versa. For example, the term "certificate of deposit" or "CD" may not be used to describe share certificates and other dividend-bearing term share accounts. Similarly, the terms "time account" (used in Regulation DD, 12 CFR § 230.2(u)) and "time deposit"

(used in Regulation D, 12 CFR § 204.2(c)) may not be used to describe term share accounts.

(b) *Advertisement*

1. *Covered messages.* Advertisements include commercial messages in visual, oral, or print media that invite, offer, or otherwise announce generally to members and potential members the availability of member accounts such as:

i. Telephone solicitations.

ii. Messages on automated teller machine (ATM) screens (including any printout).

iii. Messages on a computer screen in a credit union's lobby (including any printout) other than a screen viewed solely by the credit union's employee.

iv. Messages in a newspaper, magazine, or promotional flyer or on radio or television.

v. Messages promoting an account that are provided along with information about the member's existing account at a credit union and that promote another account at the credit union (such as account promotional messages on the periodic statement).

2. *Other messages.* Examples of messages that are not advertisements are:

i. Rate sheets published in newspapers, periodicals, or trade journals (unless the credit union or share and deposit broker that offers accounts at the credit union pays a fee to have the information included or otherwise controls publication).

ii. Telephone conversations initiated by a member or potential member about an account.

iii. An in-person discussion with a member about the terms for a specific account.

iv. Information provided to members about their existing accounts, such as on IRA disbursements, notices for automatically renewable term share accounts sent before renewal, or current rates recorded on a voice response machine.

(c) Annual Percentage Yield.

1. *General.* The annual percentage yield (APY) is required for disclosures for new accounts, oral responses to inquiries about rates; disclosures provided upon request; initial disclosures (if the credit union chooses to provide full disclosures instead of the abbreviated notice); notices prior to the renewal of a term share account, if known at the time the notice is sent, and in advertising. The annual percentage yield shows the total amount of dividends for a 365 day period (or a 366 day period for a leap year) on an assumed principal amount based on the dividend rate and frequency of compounding as a percentage of the assumed principal (for accounts such as share or share draft accounts) or for the total amount of dividends over the term of the account for term share accounts. The annual percentage yield assumes the principal amount remains in the account for 365 days (366 days for leap year) or for the term of the account.

2. *How Annual Percentage Yield Differs from Annual Percentage Yield Earned.* The annual percentage yield (APY) differs from the annual percentage yield earned (APYE). The annual percentage yield earned is required for periodic statements only. The annual percentage yield earned shows the total amount of dividends earned for the dividend or statement period as a percent of the actual average daily balance in the member's account. Unlike the annual percentage yield, the annual percentage yield earned is affected by additions and withdrawals during the period. The annual percentage yield and the annual percentage yield earned must be calculated according to the formulas provided in Appendix A to this rule.

(d) Average Daily Balance Method.

1. *General.* One of the two required methods (the daily balance is the other) of determining the balance upon which dividends must be accrued and paid. The average daily balance method requires the application of a periodic rate to the average daily balance in the account for the average daily balance calculation period. The average daily balance is determined by adding the full amount of principal in the account for each day of the period and dividing that figure by the number of days in the period.

(e) Board.

1. *General.* The NCUA Board.

(f) Bonus

1. *General.* Bonuses include items of value offered as incentives to members, such as an offer to pay the final installment deposit for a holiday club account if the final installment is over $10. Bonuses do not include the payment of dividends (including extraordinary dividends), the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, or other consideration aggregating $10 or less per year.

2. *Examples.* The following are examples of bonuses.

i. A credit union offers $25 to potential members for becoming a member and opening

an account. The $25 could be provided by check, cash, or direct deposit.

ii. A credit union offers $25 to a member with only a regular share account to open a share draft account. The $25 could be provided by check, cash, or direct deposit.

iii. A credit union offers a portable radio with a value of $20 to members and potential members for opening a share draft account.

iv. A credit union pays the final installment deposit for a holiday club account if over $10.

3. *Examples not comprising bonuses.* The following are examples of items that are not bonuses:

i. Discount coupons distributed by credit unions for use at restaurants or stores.

ii. A credit union offers $20 to any member if the member is responsible for encouraging a potential member to open an account. The $20 is not a bonus because the $20 is not paid to the individual opening the account. Any item, including cash, given or offered to a third party (that is not a joint member or joint owner in an account being opened) in exchange for a member or potential member opening (or a member renewing or adding to) an account is not a bonus.

iii. A credit union offers $25 to a member if the member can locate his name in the body of a newsletter.

iv. Life savings benefits. Many credit unions offer life savings benefits to beneficiaries of deceased members. Because the benefit accrues to a third party, such life savings plans offered are not bonuses.

v. A credit union offers to pay annual membership dues in a benevolent organization for a class of members.

4. *De minimis rule.* Items with a de minimis value of $10 or less are not bonuses. Credit unions may rely on the valuation standard used by the Internal Revenue Service (IRS) to determine if the value of the item is de minimis. Items required to be reported by the credit union under IRS rules are bonuses under this regulation. Examples of items of de minimis value are:

i. Disability insurance premiums on a share account valued at an amount of $10 or less per year.

ii. Coffee mugs, T-shirts or other merchandise with a market value of $10 or less per year.

5. *Aggregation.* In determining if an item valued at $10 or less is a bonus, credit unions must aggregate per account per calendar year items that may be given to members. In making this determination, credit unions aggregate per account only the market value of items that may be given for a specific promotion. To illustrate, assume a credit union offers in January to give members an item valued at $7 for each calendar quarter during the year that the average account balance in a share draft account exceeds $10,000. The bonus rules are triggered, since members are eligible under the promotion to receive up to $28 during the year. However, the bonus rules are not triggered if an item valued at $7 is offered to members opening a share draft account during the month of January, even though in November the credit union introduces a new promotion that includes, for example, an offer to existing share draft accountholders for an item valued at $8 for maintaining an average balance of $5,000 for the month.

6. *Waiver or reduction of a fee or absorption of expenses.* Bonuses do not include value received by members through the waiver or reduction of fees for credit union-related services (even if the fees waived exceed $10), such as the following:

i. Waiving a safe deposit box rental fee for one year for members who open a new account.

ii. Waiving fees for travelers checks for members, and waiving check and share draft printing fees.

iii. Nondiscriminatorily waiving all fees for a particular class of members, such as seniors or minors.

iv. Discounts on interest rates charged for loans at the credit union.

v. Rebates of loan interest already paid by a member.

vi. Discounts on application fees charged for loans at the credit union.

vii. Packaged, linked, or tied-account services.

7. *Non-dividend membership benefits.* Such benefits are not bonuses because they are sporadic in nature, often difficult to value, and providing non-dividend membership benefits is a long- standing unique credit union practice. (See commentary to § 707.2(r) for examples of such benefits.)

(g) Credit union.

1. *General.* Includes credit unions in the United States, Puerto Rico, Guam, U.S. Virgin Islands, and U.S. territories. Applies to credit unions whether or not the accounts in the credit union are federally, state, privately insured, or uninsured.

(h) Daily balance method.

1. *General.* One of the two required methods (the average daily balance is the other) of determining the balance upon which dividends must be accrued and paid. The daily balance method requires the application of a daily periodic rate to the full amount of principal in the account each day.

(i) Dividend and dividends.

1. *General.* Member savings placed in share accounts are equity investments, and the returns earned on these accounts are dividends. Federal credit unions may only offer dividend-bearing and non-dividend-bearing share accounts. State-chartered credit unions may offer both share and deposit accounts if permitted by state law. State law, including without limitation regulations and official interpretations, will determine if returns earned in accounts in state-chartered credit unions are dividends. Dividends exclude the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, and extraordinary dividends. Dividend-bearing accounts must be either fixed-rate or variable-rate accounts.

2. *Procedure.* Credit unions must follow appropriate law (state law for state-chartered credit unions and federal law for federal credit unions) in determining dividend policies and declaring dividends. Generally, dividends may be viewed as a portion of the available current and undivided earnings of the credit union which is set apart, after required transfers to reserves, by valid act of the board of directors, for distribution among the members. As a matter of legal procedure, members are usually not entitled to dividends until the following steps are completed: (1) the board of the credit union develops a nondiscriminatory dividend policy, by establishing dividend periods, dividend credit determination dates, dividend distribution dates, any associated penalties (if applicable), and the method of dividend computation for each type of share account; (2) the provision for required transfers to reserves are made; (3) sufficient and available prior and/or current earnings are available at the end of the dividend period; (4) the board formally makes a dividend declaration in accordance with the credit union's dividend policy; and (5) dividends must be paid to members by a credit to the appropriate share account, payment by check or share draft, or by a combination of the two methods.

3. *When available.* Credit unions must follow the law of their primary chartering authority to determine when dividends are available. Generally, it is the declaration of the dividend itself which creates the dividend and the member has no right to receive a dividend until it is so declared. The decision of when to declare dividends lies within the official discretion of each credit union's board of directors and cannot be abrogated by contract. An agreement to pay dividends on a share account is generally interpreted not as an obligation to pay the stipulated dividends absolutely and unconditionally, but as an undertaking to pay them out of the earnings when sufficiently accumulated from which dividends in general are properly payable. Generally, "prospective rates" are rates set in good faith in advance of the close of a dividend period, that may be altered if sufficient funds are not available, or in the event of a superseding event, such as a strike, plant closure, significant fluctuation in market rates and/or a significant change in financial structure, natural disaster or emergency that alters the assumptions under which the "prospective rates" were made. It is the intent of TISA that all disclosures be accurate when made, and credit unions are urged to make every effort to ratify disclosed "prospective rates." "Prospective rates" may also be referred to as "projected rates" or similar wording, but not as "estimated rates." (See comment 3(b)-2, prohibiting use of estimates).

4. *Sample dividend resolutions.*

(i) The following resolution may be used where the dividend rates are set after the close of a dividend period.

RESOLUTION OF BOARD OF DIRECTORS FOR THE DECLARATION OF DIVIDENDS

A. I, _____, certify that I am Secretary of _____ Credit Union Board of Directors, and that the following is a correct copy of the resolution for declaring dividends adopted by the _____ Credit Union at a meeting of the Board of Directors duly and properly held on _____, 19____.

This resolution appears in the minutes of this meeting and has not been rescinded or modified.

B. RESOLVED, that

(1) The Board of Directors has developed a nondiscriminatory dividend policy, by establishing dividend periods, dividend credit determination dates, dividend distribution dates, any associated penalties (if applicable), and the method of dividend computation for each type of share account;

(2) The required transfers to reserves have been made; and

(3) Sufficient and available prior and/or current earnings are available at the end of this dividend period.

C. RESOLVED, further, that the Board of Directors now formally makes a dividend declaration in accordance with the Credit Union's dividend policy and authorizes that on _____, 19____, dividends must be paid to members by a credit to the appropriate share account, payment by share draft or by a combination of the two methods.

D. I further certify that the Board of Directors of this Credit Union has, and the time of adoption of this resolution had, full power and lawful authority to adopt the foregoing resolutions and that this resolution revokes any prior resolution.

IN WITNESS WHEREOF, this is my signature and the date on which I signed this Resolution.

_____

Signature

_____

Date

[Attach list of accounts with dividend rates for each type of account.]

(ii) The following resolution may be used where the dividend rates are set before the close of a dividend period.

RESOLUTION OF BOARD OF DIRECTORS FOR THE DECLARATION OF DIVIDENDS

A. I, _____, certify that I am the Secretary of _____ Credit Union, and that the following is a correct copy of the resolution for declaring dividends adopted by the _____ Credit Union at a meeting of the Board of Directors duly and properly held on _____, 19____. This resolution appears in the minutes of that meeting and has not been rescinded or modified.

B. RESOLVED, that the Board of Directors has adopted a nondiscriminatory dividend policy, by establishing dividend periods, dividend credit determination dates, dividend distribution dates, any associated penalties (if applicable) and the method of dividend computation for each type of share account.

C. RESOLVED, that it is the policy and practice of the Board of Directors to meet periodically to establish prospective dividend rates for each type of dividend-bearing share account.

D. RESOLVED, that if the required transfers to reserves have been made and there are sufficient and available prior and/or current earnings available at the end of a dividend period, the officers of the Credit Union are authorized to pay dividends at the rate prospectively established by the Board of Directors for each account for the dividend period. The officers may pay the dividends without any further action of the Board of Directors. The act of paying the dividends shall constitute the declaration of the dividends and shall be a ratification of the prospective dividend rate.

IN WITNESS WHEREOF, this is my signature and the date on which I signed this Resolution.

_____

Signature

_____

Date

[Attach list of accounts with prospective dividend rates for each type of account.]

5. *Referencing.* Except where specifically stated otherwise, use of the term "share" in part 707, as in "share account," also refers to "deposit," as in "deposit account," where appropriate (for interest-bearing or non-interest-bearing deposit accounts at some state-chartered credit unions).

(j) Dividend declaration date.

1. *General.* The importance of the dividend declaration date is to tie the last paid dividend to a certain period of time to place members and potential members on notice that the last paid dividend is different from the next dividend to be paid. In order to achieve this purpose, a credit union may use any of the following methods:

i. "As of 3/15/95" (the date the board of directors last met and declared the last paid dividend).

ii. "As of 3/31/95" (the last day of the last dividend period upon which a dividend has been paid).

iii. "For the period 1/1/95 to 3/31/95" (the last dividend period upon which a dividend has been paid).

iv. "For the first quarter of 1995" (the last dividend period upon which a dividend has been paid).

v. "For April 1995" (the last dividend period upon which a dividend has been paid).

vi. "As of the last dividend declaration date" (the last dividend period upon which a dividend has been paid).

(k) Dividend period.

1. *General.* The dividend period is to be set by a credit union's board of directors for each account type, e.g., regular share, share draft, money market share, and term share. The most common dividend periods are weekly, monthly, quarterly, semi-annually, and annually. Dividend periods need not agree with calendar months, e.g., a monthly dividend period could begin March 15 and end April 14.

(l) Dividend rate.

1. *General.* The dividend rate does not reflect compounding. Compounding is reflected in the "annual percentage yield" definition.

2. *Referencing.* Except where specifically stated otherwise, use of the term "dividend rate" in part 707 also refers to "interest rate," where appropriate (for interest-bearing and non-interest- bearing deposit accounts at some state-chartered credit unions).

(m) Extraordinary dividends.

1. *General.* The definition encompasses all irregularly scheduled and declared dividends, and as dividends, extraordinary dividends are exempt from the "bonus" disclosure requirements. Extraordinary dividends do not have to be disclosed on account disclosures, but the dollar amount of an extraordinary dividend credited to the account during the statement period does have to be separately disclosed on the periodic statement for the dividend period during which the extraordinary dividends are earned. Extraordinary dividends, like ordinary dividends, do not include the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses or non-dividend membership benefits. See comments 2(f) 1 through 7 and 2(i) 1 through 4. Extraordinary dividends may be calculated by any means determined by the board of directors of a credit union and may not be used in the annual percentage yield earned calculation.

2. *Use of synonym.* Extraordinary dividends may be described as "bonus dividends."

(n) Fixed-rate account.

1. *General.* Includes all accounts in which the credit union, by contract, agrees to give at least 30 days advance written notice of decreases in the dividend rate. Thus, credit unions can decrease rates only after providing advance written notice of rate decreases, e.g., a "change-in-terms notice."

(o) Grace period.

1. *General.* A period after maturity of an automatically renewing term share account during which the member may withdraw funds without being assessed a penalty. Use of a "grace period" is discretionary, not mandatory. This definition does not refer to the "grace period" account, which is a synonym for "federal rollback method" or "in by the 10th" accounts, which are prohibited by TISA and part 707.

(p) Interest.

1. *General.* Member savings placed in deposit accounts are debt investments, and the return earned on these accounts is interest. Federal credit unions are not authorized to offer any interest-bearing deposit accounts. State-chartered credit unions may offer both share and deposit accounts if permitted by state law. State law, including without limitation regulations and official interpretations, will determine if returns earned in accounts in state-chartered credit unions are interest. Interest excludes the payment of a bonus or other consideration worth $10 or less given during a year, the waiver or reduction of a fee, the absorption of expenses, non-dividend membership benefits, and extraordinary dividends.

2. *Differences between Dividends and Interest.* Generally, dividends are returns on an equity investment (shares); interest is return on a debt investment (deposits). Dividends, in general, are not properly payable until declared at the close of a dividend period; interest, in general, is properly payable daily according to the deposit contract. Dividend rates are prospective until actually declared; interest rates are set according to contract in advance and are earned on that basis. Share accounts establish a member (owner)/credit union (cooperative) relationship; deposit accounts establish a depositor (creditor)/depositary (debtor) relationship.

3. *Referencing.* Except where specifically stated otherwise, use of the terms "dividend" or "dividends" in part 707 also refers to "interest" where appropriate (for interest-bearing and non-interest-bearing deposit accounts at some state-chartered credit unions).

(q) Member

1. *Professional capacity.* Examples of accounts held by a natural person in a professional capacity for another are:

i. Attorney-client trust accounts.

ii. Trust, estate and court-ordered accounts.

iii. Landlord-tenant security accounts.

2. *Other accounts.* Examples of accounts not held in a professional capacity include accounts held by parents for a child under the Uniform Gifts to Minors Act (or Uniform Transfers to Minors Act.

3. *Retirement plans.* IRAs and SEP accounts are member accounts to the extent that funds are invested in accounts subject to the regulation. Keogh accounts, like sole proprietor accounts, are not subject to the regulation.

(r) Non-dividend membership benefits.

1. *General.* Term reflects unique credit union practices that are difficult to value, encourage community spirit, and are not granted in such quantity as to be includable as calculable dividends.

2. *Examples.* Examples include:

i. Food, refreshments, and drawings and raffles at annual meetings, member functions, and branch openings.

ii. Travel club benefits.

iii. Prizes offered at annual meetings, such as U.S. Savings Bonds, a deposit of funds into the winner's account, trips, and other gifts. Such prizes are not bonuses because they are offered as an incentive to increase attendance at the annual meeting, and not to entice members to open, maintain, or renew accounts or increase an account balance.

iv. Life savings benefits.

(s) Passbook Account

1. *Relation to Regulation E.* Passbook accounts include accounts accessed by preauthorized electronic fund transfers to the account (as defined in 12 CFR § 205.2(j)), such as an account credited by direct share and deposit of social security payments. Accounts that permit access by other electronic means are not "passbook accounts," and any statements that are sent four or more times a year must comply with the requirements of 707.6.

(t) Periodic Statement

1. *General.* Periodic statements are not required by part 707. Passbook and term share accounts are exempt from periodic statement requirements.

2. *Examples.* Periodic statements do not include:

i. Additional statements provided solely upon request.

ii. Information provided by computer through home electronic credit union account services.

iii. General service information such as a quarterly newsletter or other correspondence that describes available services and products.

(u) Potential Member.

1. *General.* A potential member is a natural person eligible for membership in a credit union, who has not yet taken the steps necessary to become a member. The term also includes natural person nonmembers eligible to hold accounts in a credit union pursuant to relevant federal or state law.

2. *Verification of eligibility.* It is recommended that credit unions have sound written procedures in place to identify those eligible for membership. If these procedures include verification measures, such as an application process, verification telephone call or letter to an employer or association within the field of membership, witnessing by an existing member, or similar procedure, then the credit union may first verify the membership eligibility of a potential member before providing account disclosures or other information to the potential member. This process of verifying a member's eligibility status, making a recommendation for membership, and providing account disclosures should be completed within 20 calendar days. This period also applies when potential members not on credit union premises request disclosures.

3. *Nonmembers.* Within its sole discretion, the board of directors of a credit union may provide TISA disclosures to nonmembers who are ineligible for membership or to hold an account at the credit union. If disclosures are made to such nonmembers, it is the position of the Board that no civil liability can accrue to the credit union for any errors in such disclosures. (See commentary to 707.3(d)).

(v) State

General. Territories and possessions include American Samoa, Guam, the Mariana Islands, and the Marshall Islands.

(w) Stepped-rate account

1. *General.* Stepped-rate accounts are those accounts in which two or more dividend rates (known at the time the account is opened) will take effect in succeeding periods.

2. *Example.* An example of a stepped-rate account is a one-year term share certificate

account in which a 5.00 percent dividend rate is paid for the first six months, and 5.50 percent for the second six months.

(x) Term share account

1. *Relation to Regulation D.* Regulation D permits, in limited circumstances, the withdrawal of funds without penalty during the first six days after a "time deposit" is opened. (See 12 CFR § 204.2(c)(1)(i).) But the fact that a member makes a withdrawal as permitted by Regulation D does not disqualify the account from being a term share account for purposes of this regulation (such as withdrawals upon the death of the member, or within a "grace period" for automatically renewable term share accounts).

2. *Club accounts.* Club accounts, including Christmas club, holiday club, and vacation club accounts may be either term share or regular share accounts, depending on the terms of the account. Although club accounts typically have a maturity date, they are not term share accounts unless they also require a penalty of at least seven days' dividends for withdrawals during the first six days after the account is opened.

(y) Tiered-rate Account

1. *General.* Tiered-rate accounts are those accounts in which two or more dividend rates are paid on the account and are determined by reference to a specified balance level. Tiered-rate accounts are of two types: Tiering Method A and Tiering Method B. In Tiering Method A accounts, the credit union pays the applicable tiered dividends rate on the entire amount in the account. This method is also known as the "hybrid" or "plateau" tiered-rate account. In Tiering Method B accounts, the credit union does not pay the applicable tiered dividends rate on the entire amount in the account, but only on the portion of the share account balance that falls within each specified tier. This method is also known as the "pure" or "split-rate" tiered-rate account. (See Appendix A, Section I, D.)

2. *Example.* An example of a tiered-rate account is one in which a credit union pays a 5.00 percent dividend rate on balances below $1,000, and 5.50 percent on balances $1,000 and above.

3. *Term share accounts.* Term share accounts that pay different rates based solely on the amount of the initial share and deposit are not tiered-rate accounts.

4. *Minimum balance accounts.* A requirement to maintain a minimum balance to earn dividends does not make an account a tiered-rate account. If dividends are not paid on amounts below a specified balance level, then the account has a minimum balance requirement (required to be disclosed under § 707.4(b)(3)(i)), but the account does not constitute a tiered-rate account. A zero rate (0%) cannot constitute a tier. Minimum balance accounts are single rate accounts with a minimum balance requirement.

(z) Variable-rate account

1. *General.* Includes accounts in which the credit union does not contract to give at least 30 days advance written notice of decreases in the dividend rate. An account meets this definition whether the rate change is determined by reference to an index, by use of a formula, or merely at the discretion of the credit union's board of directors. An account that permits one or more rate adjustments prior to maturity at the member's option, such as a rate relock option, is a variable-rate account.

2. *Differences between fixed-rate and variable-rate accounts.* All accounts must either be fixed-rate or variable-rate accounts. Classifying an account as variable-rate affects credit unions three ways:

i. Additional account disclosures are required (§ 707.4(b)(1)(ii));

ii. Rate decreases are exempted from change-in-terms requirements (§ 707.5(a)(2)(i)); and

iii. Advertising notice required (§ 707.8(c)(1)). Fixed-rate accounts require a contract term obligating the credit union to a 30-day advance, written notice to members before decreasing the dividend rate on the account. Term changes adversely affecting the member and rate decreases cannot take effect until 30 days after such fixed-rate change-in-terms notices are mailed or delivered to members (§ 707.5(a)).

§ 707.3—General disclosure requirements.

(a) Form

1. *General.* All required disclosures (e.g., account disclosures, change-in-terms notices, term share renewal/maturity notices, statement disclosures and advertising disclosures) must be made clearly and conspicuously, in a form the member may retain. Disclosures need be made only as applicable (e.g., disclosures for a non-dividend-bearing account would not include disclosure of annual percentage yield, dividend rate, or other disclosures pertaining to dividend calculations).

2. *Design requirements.* Disclosures must be presented in a format that allows members and potential members to readily understand the terms of their account. Credit unions are not required to use a particular type size or typeface, nor are credit unions required to state any term more conspicuously than any other term. Disclosures may be made:

i. In any order.

ii. In combination with other disclosures or account terms.

iii. In combination with disclosures for other types of accounts, as long as it is clear to members and potential members which disclosures apply to their account.

iv. On more than one page and on the front and reverse sides.

v. By using inserts to a document or filling in blanks.

vi. On more than one document, as long as the documents are provided at the same time.

3. *Consistent terminology.* A credit union must use the same terminology to describe terms or features that are required to be disclosed. For example, if a credit union describes a monthly fee (regardless of account activity), as a "monthly service fee" in account opening disclosures, the periodic statements and change-in-terms notices must use the same terminology so that members and potential members can readily identify the fee.

(b) General

1. *Terms and conditions.* Credit unions are required to have disclosures reflect the terms of the legal obligation between the credit union and a member at the time the member opens the account. This provision does not impose any contract terms or supersede state or other laws that define how the legal obligations between a credit union and its membership are determined.

2. *Specificity of legal obligation.* Credit unions may refer to the calendar month or to roughly equivalent intervals during a calendar year as a "month." Use of estimates is prohibited in TISA disclosures.

3. *Foreign language.* Disclosures may be made in any foreign language, if desired by the board of directors of a credit union. However, disclosures must also be provided in English, upon request.

(c) Relation to Regulation E

1. *General rule.* Compliance with Regulation E (12 CFR part 205) is deemed to satisfy the disclosure requirements of this regulation, such as when:

i. A credit union changes a term that triggers a notice under Regulation E, and the timing and disclosure rules of Regulation E for sending change-in-terms notices.

ii. A member adds an ATM access feature to an account, and the credit union provides disclosures pursuant to Regulation E, including disclosure of fees before the member receives ATM access. (See 12 CFR § 205.7.)

iii. A credit union complying with the timing rules of Regulation E discloses at the same time fees for electronic services (such as balance inquiry fees imposed if the inquiry is made at an ATM) that are required to be disclosed by this regulation, but not by Regulation E.

iv. A credit union relies on Regulation E's rules regarding disclosures of limitations on the frequency and amount of electronic fund transfers, including security-related exceptions. But any limitation on the number of "intra-institutional transfers" to or from the member's other accounts at the credit union during a given time period must be disclosed, even though intra-institutional transfers are exempt from Regulation E.

(d) Multiple members

1. *General.* When an account has multiple natural person member accountholders, delivery of disclosures to any member accountholder or agent authorized by the accountholder satisfies the disclosure requirements of part 707.

(e) Oral response to inquiries

1. *Application of rule.* Credit unions need not provide rate information orally. Disclosures need be made only as appropriate. For example, the requirement to give a telephone number for a member to call about rates for interest-bearing accounts and dividend-bearing term share accounts, would not be necessary for members calling the credit union for information. Also, the disclosure requirements are applicable only to credit union employees and volunteers acting in the ordinary course of credit union business.

2. *Relation to advertising.* The advertising rules do not cover an oral response to a question about rates.

3. *Existing accounts.* This paragraph does not apply to oral responses about rate information for existing term share accounts or accounts not currently offered. For example, if a member holding a one-year term share account requests dividend rate information about the

account during the term, the credit union need not disclose the annual percentage yield, unless the member is calling for rate information under a maturity notice.

(f) Rounding and accuracy rules for rates and yields

(f)(1) Rounding

1. *Permissible rounding.* The annual percentage yield, annual percentage yield earned and dividend rate must be rounded to the nearest one-hundredth of one percentage point (.01%) when disclosed. Examples of permissible rounding are an annual percentage yield calculated to be 5.644%, rounded down and shown as 5.64%; 5.645% would be rounded up and disclosed as 5.65%. For account disclosures, the dividend rate may be expressed to more than two decimal places.

(f)(2) Accuracy

1. *Annual percentage yield and annual percentage yield earned.* The tolerance for annual percentage yield and annual percentage yield earned calculations is designed to accommodate inadvertent errors. Credit unions may not purposely incorporate the one- twentieth of one percentage point (.05%) tolerance into their calculation of yields.

2. *Dividend rate.* There is no tolerance for an inaccuracy in the dividend rate.

§ 707.4—Account disclosures.

(a) Delivery of account disclosures

(a)(1) Account opening

1. *New accounts.* New account disclosures must be provided when:

i. A term share account that does not automatically rollover is renewed by a member.

ii. A member changes the term for a renewable term share account (from a one-year term share account to a six-month term share account, for instance)(see comment 5(b)-5 regarding disclosure alternatives).

iii. A credit union transfers funds from an account to open a new account not at the member's request, unless the credit union previously gave account disclosures and any change-in-terms notices for the new account (e.g., funds in a money market share account are transferred by a credit union to open a new account for the member, such as a share draft account, because the member exceeded transaction limitations on the money market share account).

iv. A credit union accepts a deposit from a member to an account that the credit union had previously deemed to be "closed," under applicable federal or state law, for the purpose of treating accrued, but uncredited, dividends as forfeited dividends. New account numbers are not required by this requirement.

2. *Acquired accounts.* New account disclosures need not be given when a credit union acquires an account through an acquisition of, or merger with, another credit union (but see 707.5(a) regarding advance notice requirements if terms are changed).

3. *Combination disclosures.* New account disclosures need not be given when a member has already received disclosures covering several accounts, and opens a new account properly disclosed by the already received combination disclosures, if the new account is opened within a reasonable amount of time after receipt of the combination disclosures and if the received disclosures and terms are accurate at the time the new account is opened.

(a)(2) Requests

(a)(2)(i)

1. *Inquiries versus requests.* A response to an oral inquiry (by telephone or in person) about rates and yields or fees does not trigger the duty to provide account disclosures. But, when a member asks for written information about an account (whether by telephone, in person, or by other means), the credit union must provide disclosures unless the account is no longer offered to the public.

2. *General requests.* When members or potential members request disclosures about a type of account (a share draft account, for example), a credit union that offers several variations may provide disclosures for any one of them. No disclosures need be made to nonmembers, though a credit union may provide disclosures to nonmembers within its sole discretion.

3. *Timing for response.* Twenty calendar days is a reasonable time for responding to a request for account information that a member does not make in person.

(a)(2)(ii)(A)(2)

1. *Recent rates.* Credit unions comply with this paragraph if they disclose an interest rate (or dividend rate on a dividend- bearing term share account) and annual percentage yield accurate within the seven calendar days preceding the date they send the disclosures.

(a)(2)(ii)(B)

1. *Term.* Describing the maturity of a term share account as "1 year" or "6 months," for example, illustrates a response stating the

maturity of a term share account as a term rather than a date (e.g., "June 1, 1995").

(b) Content of account disclosures

(b)(1) Rate information

(b)(1)(i) Annual percentage yield and dividend rate

1. *Rate disclosures.* In addition to the dividend rate and annual percentage yield, credit unions may disclose a periodic rate corresponding to the dividend rate. No other rate or yield (such as "tax effective yield") is permitted. If the annual percentage yield is the same as the dividend rate, credit unions may disclose a single figure but must use both terms.

2. *Fixed-rate accounts.* For fixed-rate term share accounts paying the opening rate until maturity, credit unions may disclose the period of time the dividend rate will be in effect by stating, or cross-referencing, the maturity date. For other fixed-rate accounts, credit unions may use a date (such as "This rate will be in effect through June 30, 1995") or a period (such as "This rate will be in effect for at least 30 days").

3. *Tiered-rate accounts.* Each dividend rate, along with the corresponding annual percentage yield for each specified balance level (or range of annual percentage yields, if appropriate), must be disclosed for tiered-rate accounts. (See Appendix A, Part I, Paragraph D.)

4. *Stepped-rate accounts.* A single composite annual percentage yield must be disclosed for stepped-rate accounts. (See Appendix A, Part I, Paragraph B.) The dividend rates and the period of time each will be in effect also must be provided. When the initial rate offered for a specified time on a variable-rate account is higher or lower than the rate that would otherwise be paid on the account, the calculation of the annual percentage yield must be made as if for a stepped-rate account. (See Appendix A, Part I, Paragraph C.)

5. *Minimum balance accounts.* If a credit union sets a minimum balance to earn dividends, the credit union may, but need not, state that the annual percentage yield is 0% for those days the balance in the account drops below the minimum balance level when using the daily balance method. Nor is a disclosure of 0% required for credit unions using the average daily balance method, if the member fails to meet the minimum balance required for the average daily balance period.

(b)(1)(ii) Variable rates

(b)(1)(ii)(B)

1. *Determining dividend rates.* To disclose how the dividend rate is determined, credit unions must:

i. Identify the index and specific margin, if the dividend rate is tied to an index.

ii. State that rate changes are within the credit union's discretion, if the credit union does not tie changes to an index.

(b)(1)(ii)(C).

1. *Frequency of rate changes.* A credit union reserving the right to change rates at its discretion must state the fact that rates may change at any time.

(b)(1)(ii)(D)

1. *Limitations.* A floor or ceiling on rates or on the amount the rate may decrease or increase during any time period must be disclosed. Credit unions need not disclose the absence of limitations on rate changes.

(b)(2) Compounding and crediting

(b)(2)(i) Frequency

1. *General.* Descriptions such as "quarterly" or "monthly" are sufficient. Irregular crediting and compounding periods, such as if a cycle is cut short at year end for tax reporting purposes, need not be disclosed.

2. *Dividend period.* For dividend-bearing accounts, the dividend period must be disclosed. (A specific example must also be given, see Appendix B, B-1(c).) The dividend period for term share accounts generally may be disclosed as the account's term (e.g., two years).

(b)(2)(ii) Effect of closing an account

1. *Deeming an account closed.* A credit union may, subject to state or other law, provide in account contracts the actions by members that will be treated as closing the account and that will result in the forfeiture of accrued but uncredited dividends. An example is the withdrawal of all funds from the account prior to the date dividends are credited. Credit unions are cautioned that bylaw requirements may prevent a credit union from deeming a member's account closed until certain time periods are extinguished if funds remain in a member's account. *NCUA Standard FCU Bylaws*, Art. III, section 3 (members have at least six months to replenish membership share before membership terminates and account is deemed closed). Such bylaw requirements may not be overridden without proper agency approval.

(b)(3) Balance information

(b)(3)(i) Minimum balance requirements

1. *Par value.* Credit unions must disclose any minimum balance required to open the

account, to avoid the imposition of a fee, or to obtain the annual percentage yield. Since members cannot generally maintain any accounts until the par value of the membership share is paid in full, this section requires that credit unions disclose the par value of a share necessary to become a member and maintain accounts at the credit union. The par value of a share and the minimum balance requirement do not have to be the same amount (e.g., a credit union may have a $5 par value for a membership share, in order for accounts to be opened and maintained, and a $100 minimum balance requirement, in order for the account to earn dividends).

2. *Disclosures.* The explanation of minimum balance computation methods may be combined with the balance computation method disclosures (§ 707.4(b)(3)(ii)) if they are the same. If a credit union uses different cycles for determining minimum balance requirements for purposes of assessing fees and for paying dividends, the credit union must disclose the specific cycle or time period used for each purpose (e.g., use of a midmonth statement cycle for determining dividends, and use of a calendar month cycle for determining fees). Credit unions may assess fees by using any method. If fees on one account are tied to the balance in another account, such provision must be explained (e.g., if share draft fees are tied to a minimum balance in the regular share account (or a combination of the share draft and regular share accounts), the share draft account must explain that fact and how the balance in the regular share account (or both accounts) is determined). The fee need not be disclosed in the account disclosures if the fee is not imposed on that account.

(b)(3)(ii) Balance computation method

1. *Methods and periods.* Credit unions may use different methods or periods to calculate minimum balances for purposes of imposing a fee (the daily balance for a calendar month, for example) and accruing dividends (the average daily balance for a statement period, for example). Each method and corresponding period must be disclosed.

(b)(3)(iii) When dividends begin to accrue

1. *Additional information.* Credit unions must include a statement as to when dividends begin to accrue for noncash deposits. Credit unions may disclose additional information such as the time of day after which deposits are treated as having been received the following business day, and may use additional descriptive terms such as "ledger" or "collected" balances to disclose when dividends begin to accrue. Under the ledger balance method, dividends begin to accrue on the day of deposit. Under the collected balance method, dividends begin to accrue when provisional credit is received for the item deposited.

(b)(4) Fees

1. *Types of fees.* Fees related to the routine use of an account must be disclosed. The following are types of fees that must be disclosed in connection with an account:

i. Maintenance fees, such as monthly service fees.

ii. Fees related to share deposits or withdrawals.

iii. Fees for special services, such as stop payment fees, fees for balance inquiries or verification of shares and deposits, fees associated with checks returned unpaid, fees for regularly sending to members share drafts that otherwise would be held by the credit union, and overdraft line of credit access fees (if charged against the share account).

iv. Fees to open or to close an account.

v. Fees imposed upon dormant or inactive accounts.

2. *Other fees.* Credit unions need not disclose fees such as the following:

i. Fees for services offered to members and nonmembers alike, such as fees for certain travelers checks, for wire transfers and automated clearinghouse (ACH) transfers, to process credit card cash advances, or to handle U.S. Savings Bond redemption (even if different amounts are charged to members and nonmembers).

ii. Incidental fees, such as fees associated with state escheat laws, garnishment or attorneys fees, to change names on an account, to generate a midcycle periodic statement, to wrap loose coins, for photocopying for statements returned to the credit union because of a wrong address, and locator fees.

3. *Amount of fees.* Credit unions are cautioned that merely providing fee information in an account disclosure may not be sufficient to gain the legal right to impose the fee involved under applicable law. Credit unions must state the amount and conditions under which a fee may be imposed. Naming and describing the fee typically satisfies this requirement. Some examples are:

i. "$4.00 monthly service fee".

ii. "$7.00 and up" or "fee depends on style of checks ordered" for check printing fees.

4. *Tied-accounts.* Credit unions must state if fees that may be assessed against an account are tied to other accounts at the credit union. For example, if a credit union ties the fees payable on a share draft account to balances held in the share draft account and in a regular share account, the share draft account disclosures must state that fact and explain how the fee is determined.

5. *Regulation E statements.* Some fees are required to be disclosed under both Regulation E (12 CFR §205.7) and part 707. If such fees, such as ATM transaction fees, are disclosed on a Regulation E statement, they need not be disclosed again on a periodic statement required under part 707.

(b)(5) Transaction limitations

1. *General rule.* Examples of limitations on the number or dollar amount of share deposits or withdrawals that credit unions must disclose are:

i. Limits on the number of share drafts or checks that may be written on an account for a given time period.

ii. Limits on withdrawals or share deposits during the term of a term share account.

iii. Limitations required by Regulation D, such as the number of withdrawals permitted from money market share accounts by check to third parties each month (credit unions need not disclose reservation of right to require a notice for withdrawals from accounts required by federal or state law).

(b)(6) Features of term share accounts

(b)(6)(i) Time requirements

1. "*Callable*" term share accounts. In addition to the maturity date, credit unions must state the date or the circumstances under which the credit union may redeem a term share account at the credit union's option (a "callable" term share account).

(b)(6)(ii) Early withdrawal penalties

1. *General.* The term "penalty" may, but need not, be used to describe the loss that may be incurred by members for early withdrawal of funds from term share accounts.

2. *Examples.* Examples of early withdrawal penalties are:

i. Monetary penalties, such as a specific dollar amount (e.g., "$10.00") or a specific days' worth of dividends (e.g., "seven days' dividends plus accrued but uncredited dividends, but only if the account is closed").

ii. Adverse changes to terms such as the lowering of the dividend rate, annual percentage yield, or reducing the compounding or crediting frequency for funds remaining in shares or on deposit.

iii. Reclamation of bonuses

3. *Relation to rules for IRAs or similar plans.* Penalties imposed by the Internal Revenue Code for certain withdrawals from IRAs or similar pension or savings plans are not early withdrawal penalties for purposes of this regulation.

4. *Disclosing penalties.* Penalties may be stated in months, whether credit unions assess the penalty using the actual number of days during the period or using another method such as a number of days that occurs in any actual sequence of the total calendar months involved. For example, stating "one month's dividends" is permissible, whether the credit union assesses 30 days' dividends during the month of April, or selects a time period between 28 and 31 days for calculating the dividends for all early withdrawals regardless of when the penalty is assessed.

(b)(6)(iv) Renewal policies

1. *Rollover term share accounts.* Credit unions are not required to provide a grace period, to pay dividends during the grace period, or to disclose whether or not dividends will be paid during the grace period. Credit unions offering a grace period on term share accounts must give the length of the grace period. Commentary, Appendix B, Model Clauses, B-1(i)(iv).

2. *Nonrollover term share accounts.* Credit unions that pay dividends on funds following the maturity of term share accounts that do not renew automatically need not state the rate (or annual percentage yield) that may be paid.

(b)(7) Bonuses

1. *General.* Credit unions are required to state the amount and type of bonus, and disclose any minimum balance or time requirement to obtain the bonus and when the bonus will be provided. If the minimum balance or time requirement is otherwise required to be disclosed, credit unions need not duplicate the disclosure for purposes of this paragraph.

(b)(8) Nature of dividends

1. *General.* Dividends are not payable until declared and unless sufficient current and undivided earnings are available after required transfers to reserves at the close of a dividend

period. A disclosure explaining dividends educates members and protects credit unions in the event that a prospective dividend cannot be paid, or is not properly payable. This disclosure is required for all dividend-bearing share accounts. Term share accounts need not include a statement regarding the nature of dividends.

2. *State-chartered credit unions with interest-bearing deposit accounts.* State law controls the nature of accounts (i.e., whether an account is a share account or a deposit account). If a member of a state-chartered credit union is opening only an interest-bearing deposit account, or is requesting account disclosures only for an interest-bearing deposit account (if state law requires the depositor to hold a share account), the disclosures must generally include the following information on any dividend-bearing share portion of the account (e.g., membership share): the par value of a share; a statement that the portion of the deposit that represents the par value of the membership share will earn dividends; and that dividends are paid from current income and available earnings after required transfers to reserves. Further additional disclosures, such as a separate dividend rate and annual percentage yield for the membership share, are not required (if the additional disclosures would agree with the remainder of the account which is invested in an interest-bearing deposit).

(c) Notice to existing accountholders

1. *General.* Only members who receive periodic statements (provided regularly at least four times per year) and who hold accounts of the type offered by the credit union as of the compliance date of part 707 (generally January 1, 1995) must receive the notice. If following receipt of the notice members request disclosures, credit unions have twenty calendar days from receipt of the request to provide the disclosures. Rate and annual percentage yield information in such disclosures must conform to that required for disclosures upon request. As an alternative to including the notice in or on the periodic statement, the final rule permits credit unions to send the account disclosures themselves, as long as they are sent at the same time as the periodic statement (the disclosures may be mailed either with the periodic statement or separately).

2. *Form of the notice.* The notice may be included on the periodic statement, in a member newsletter, or on a statement stuffer or other insert, if it is clear and conspicuous. The notice cannot be sent in a separate mailing from the periodic statement.

3. *Timing.* The notice may accompany the first periodic statement after the compliance date for part 707, or the periodic statement for the first cycle beginning after that date. For example, a credit union's statement cycle is December 15, 1994—January 14, 1995. The statement is mailed on January 15. The next cycle is January 15, 1995 through February 14, 1995, and the statement for that cycle is mailed on February 15. The credit union may provide the notice either on or with the January 15 statement or on or with the February 15 statement, as it covers the first cycle after January 1, 1995.

4. *Early compliance.* Credit unions that provide the notice to existing members prior to the compliance date of part 707, must be prepared to provide accurate and timely disclosures when, following receipt of the notice, members ask for account disclosures. Such disclosures must be provided even if they are requested before the compliance date of part 707. Credit unions who provide early notice to existing members need to comply with other aspects of part 707, but need not provide disclosures already provided in compliance with part 707.

§ 707.5—Subsequent disclosures.

(a) Change in terms

(a)(1) Advance notice required

1. *Form of notice.* Credit unions may provide a change-in-term notice on or with a regular periodic statement or in another mailing (such as a highlighted portion of a newsletter or statement stuffer insert). If a credit union provides notice through revised account disclosures, the changed term must be highlighted in some manner. For example, credit unions may state that a particular fee has been changed (also specifying the new amount) or use an accompanying letter that refers to the changed term. Credit unions are cautioned that unless credit unions have reserved the right to change terms in the account agreement or disclosures, a change-in-terms notice may not be sufficient to amend the terms under applicable law.

2. *Effective date.* An example of language for disclosing the effective date of a change is: "As of May 11, 1995."

3. *Terms that change upon the occurrence of an event.* A credit union offering terms that will automatically change upon the occurrence of a stated event need not send an advance notice of

the change provided the credit union fully describes the conditions of the change in the account opening disclosures (and sends any change-in-term notices regardless of whether the changed term affects that member's account at that time).

4. *Examples.* Examples of changes not requiring an advance change-in-terms notice are:

i. The termination of employment for employee-members for whom account maintenance or activity fees were waived during their employment by the credit union.

ii. The expiration of one year in a promotion described in the account opening disclosures to "waive $4.00 monthly service charges for one year".

(a)(2) No notice required

(a)(2)(ii) Check printing fees

1. *Increase in fees.* A notice is not required for an increase in fees for printing share drafts (or deposit and withdrawal slips) even if the credit union adds some amount to the price charged by the vendor.

(b) Notice before maturity for term share accounts longer than one month that renew automatically

1. *Maturity dates on nonbusiness days.* In determining the term of a term share account, credit unions may disregard the fact that the term will be extended beyond the disclosed number of days if the maturity date falls on a nonbusiness day. For example, a holiday or weekend may cause a "one-year" term share account to extend beyond 365 days (or 366, in a leap year), or a "one-month" term share account to extend beyond 31 days.

2. *Disclosing when rates will be determined.* Ways to disclose when the annual percentage yield will be available include the use of:

i. A specific date, such as "October 28".

ii. A date that is easily discernible, such as "the Tuesday prior to the maturity date stated on the notice" or "as of the maturity date stated on this notice".

3. *Alternative timing rule.* Under the alternative timing rule, a credit union that offers a 10-day grace period would have to provide the disclosures at least 10 calendar days prior to the scheduled maturity date.

4. *Club accounts.* If members have agreed to the transfer of payments from another account to a club term share account for the next club period, the credit union must comply with the requirements for automatically renewable term share accounts—even though members may withdraw funds from the club account at the end of the current club period.

5. *Renewal of a term share account.* In the case of a change-in- terms that becomes effective if a rollover term share account is subsequently renewed:

i. If the change is initiated by the credit union, the disclosure requirements of this paragraph apply. (Paragraph 707.5(a) applies if the change becomes effective prior to the maturity of the existing term share account.)

ii. If the change is initiated by the member, the account opening disclosure requirements of § 707.4(b) apply. (If the notice required by this paragraph has been provided, credit unions may give new account disclosures or disclosures that reflect the new term.)

6. *Example.* If a member receives a notice prior to maturity on a one-year term share account and requests a rollover to a six- month account, the credit union must provide either account opening disclosures including the new maturity date or, if all other terms previously disclosed in the prematurity notice remain the same, only the new maturity date.

(b)(1) Maturities of longer than one year

1. *Highlighting changed terms.* Credit unions need not highlight terms that have changed since the last account disclosures were provided.

(c) Notice for term share accounts one month or less that renew automatically

1. *Providing disclosures within a reasonable time.* Generally, 20 calendar days after an account renews is a reasonable time for providing disclosures. For term share accounts shorter than 20 days, disclosures should be given prior to the next scheduled renewal date. For example, if a term share account automatically renews every seven days, disclosures about an account that renews on Wednesday, December 6, 1995, should be given prior to Wednesday, December 13, 1995.

(d) Notice before maturity for term share accounts longer than one year that do not renew automatically

1. *Subsequent account.* When funds are transferred following maturity of a nonrollover term share account, credit unions need not provide account disclosures unless a new account is established.

§ 707.6—Periodic statement disclosures.

(a) Rule When Statement and Crediting Periods Vary

1. *General.* Credit unions are not required to provide periodic statements. If they provide periodic statements, disclosures need only be furnished to the extent applicable. For example, if no dividends are earned for a statement period, credit unions need not state that fact. Or, credit unions may disclose "$0" dividends earned and "0%" annual percentage yield earned.

2. *Regulation E interim statements.* When a credit union provides regular quarterly statements, and in addition provides a monthly interim statement to comply with Regulation E, the interim statement need not comply with this section unless it states dividend or rate information. (See 12 CFR §205.9.) For credit unions that choose not to treat Regulation E activity statements as part 707 periodic statements, the quarterly periodic statement must reflect the annual percentage yield earned and dividends earned for the full quarter. However, credit unions choosing this option need not redisclose fees already disclosed on an interim Regulation E activity statement on the quarterly periodic statement. For credit unions that choose to treat Regulation E activity statements as part 707 periodic statements, the Regulation E statement must meet all part 707 requirements.

3. *Combined statements.* Credit unions may provide certain information about an account (such as a money market share account or regular share account) on the periodic statement for another account (such as a share draft account) without triggering the disclosures required by this section, as long as:

i. The information is limited to information such as the account number, the type of account, balance information, accountholders' names, and social security or tax identification number; and.

ii. The credit union also provides members a periodic statement complying with this section for the account (the money market share account or regular share account, in the example).

4. *Other information.* Additional information that may be given on or with a periodic statement, includes:

i. Dividend rates and corresponding periodic rates to the dividend rate applied to balances during the statement period.

ii. The dollar amount of dividends earned year-to-date.

iii. Bonuses paid (or any de minimis consideration of $10 or less).

iv. Fees for other products, such as safe deposit boxes.

v. Accounts not covered by the periodic statement disclosure requirements (passbook and term share accounts) may disclose any information on the statement related to such accounts, so long as such information is accurate and not misleading.

5. *When statement and crediting periods vary.* This rule permits credit unions, on dividend-bearing share accounts, to report the annual percentage yield earned and the amount of dividends earned on a statement other than on each periodic statement when the dividend period does not agree with, varies from, or is different than, the statement period. For dividend- bearing share accounts, credit unions may disclose the required information either upon each periodic statement, or on the statement on which dividends are actually earned (credited or posted) to the member's account. In addition, for accounts using the average daily balance method of calculating dividends, when the average daily balance period and the statement periods do not agree, vary or are different, credit unions may also report annual percentage yield earned and the dollar amount of dividends earned on the periodic statement on which the dividends or interest is earned. For example, if a credit union has quarterly dividend periods, or uses a quarterly average daily balance on an account, the first two monthly statements may not state annual percentage yield earned and dividends earned figures; the third "monthly" statement will reflect the dividends earned and the annual percentage yield earned for the entire quarter. The fees imposed disclosure must be given on the periodic statement on which they are imposed.

6. *Length of the period.* Credit unions must disclose the length of both the dividend period (or average daily balance calculation period) and the statement period. For example, a statement could disclose a statement period of April 16 through May 15 and further state that "the dividends earned and the annual percentage yield earned are based on your dividend period (or average daily balance) for the period April 1 through April 30."

7. *Dividend period more frequent than statement period.* Credit unions that calculate dividends on a monthly basis, but send statements on a quarterly basis, may disclose a single divi-

dend (and annual percentage yield earned) figure. Alternatively, a credit union may disclose three dividends earned and three annual percentage yield earned figures, one for each month in the quarter, as long as the credit union states the number of days (or beginning and ending date) in each dividend period if it varies from the statement period.

8. *Additional voluntary disclosures.* For credit unions not disclosing the annual percentage yield earned and dividends earned on all periodic statements, credit unions may place a notice on statements without dividends and annual percentage yield earned figures, that the annual percentage yield earned and dollar amount of dividends earned will appear on the first statement at the close of the dividend (or average daily balance) period, or similar wording. Credit unions may also choose to include a telephone number to call for interim information, if desired by a member.

(b) Statement Disclosures

(b)(1) Annual percentage yield earned

1. *Ledger and collected balances.* Credit unions that accrue interest using the collected balance method may use either the ledger or collected balance methods to determine the balance used to determine the annual percentage yield earned. Ledger balance means the record of the balance in a member's account, as per the credit union's records. (The ledger balance may reflect additions and deposits for which the credit union has not yet received final payment). Collected balance means the record of balance in a member's account reflecting collected funds, that is, cash or checks deposited in the credit union which have been presented for payment and for which payment has actually been received. (See Regulation CC, 12 CFR § 229.14).

(b)(2) Amount of dividends or interest

1. *Definition of earned.* The term "earned" is defined to include dividends and interest either "accrued" or "paid and credited." Credit unions may use either the "ledger" or the "collected" balance for either option. (See 707.6(b)(1)1 and 707.7(c)(2) of the Appendix.)

2. *Accrued interest.* Credit unions must state the amount of interest that accrued during the statement period, even if it was not credited.

3. *Terminology.* In disclosing dividends earned for the period, credit unions must use the term "dividends" or terminology such as:

"Dividends paid," to describe dividends that have been credited;

"Dividends accrued," to indicate that dividends are not yet credited.

4. *Closed accounts.* If a member closes an account between crediting periods and forfeits accrued dividends, the credit union may not show any figures for "dividends earned" or annual percentage yield earned for the period (other than zero, at the credit union's option).

5. *Extraordinary dividends.* Extraordinary dividends are not a component of the annual percentage yield earned or the dividend rate, but are an addition to the member's account. The dollar amount of the extraordinary dividends paid, denoted as a separate, identified figure, must be disclosed on the periodic statement on which the extraordinary dividends are earned. A credit union may also disclose information regarding the calculation of the extraordinary dividends, and additional annual percentage yield earned and dividend rate figures taking into account the extraordinary dividend, so long as such information is accurate and not misleading.

(b)(3) Fees imposed

1. *General.* Periodic statements must state fees disclosed under 707.4(b) that were debited to the account during the statement period, even if assessed for an earlier period.

2. *Itemizing fees by type.* In itemizing fees imposed more than once in the period, credit unions may group fees if they are the same type. But, the description must make clear that the dollar figure represents more than a single fee, for example, "total fees for checks written this period." Examples of fees that may not be grouped together are:

i. Monthly maintenance with excess activity fees.

ii. "Transfer" fees, if different dollar amounts are imposed—such as $.50 for share deposits and $1.00 for withdrawals.

iii. Fees for electronic fund transfers with fees for other services, such as balance inquiry or maintenance fees.

3. *Identifying fees.* Statement details must enable the member to identify the specific fee. For example:

i. Credit unions may use a code to identify a particular fee if the code is explained on the periodic statement or in documents accompanying the statement.

ii. Credit unions using debit slips may disclose the date the fee was debited on the periodic statement and show the amount and type of fee on the dated debit slip.

4. *Relation to Regulation E.* Disclosure of fees in compliance with Regulation E complies with this section for fees related to electronic fund transfers (for example, totaling all electronic funds transfer fees in a single figure).

(b)(4) Length of period

1. *General.* Credit unions providing the beginning and ending dates of the period must make clear whether both dates are included in the period. For example, stating "April 1 through April 30" would clearly indicate that both April 1 and April 30 are included in the period.

2. *Opening or closing an account mid-cycle.* If an account is opened or closed during the period for which a statement is sent, credit unions must calculate the annual percentage yield earned based on account balances for each day the account was open.

§ 707.7—Payment of dividends.

(a) Permissible methods

1. *Prohibited calculation methods.* Calculation methods that do not comply with the requirement to pay dividends on the full amount of principal in the account each day include:

i. The "rollback" method, also known as the "grace period" or "in by the 10th" method, where credit unions pay dividends on the lowest balance in the account for the period.

ii. The "increments of par value" method, where credit unions only pay dividends on full shares in an account, e.g., a credit union with $5 par value shares pays dividends on $20 of a $24 account balance.

iii. The "ending balance" method, where credit unions pay dividends on the balance in the account at the end of the period.

iv. The "investable balance" method, where credit unions pay dividends on a percentage of the balance, excluding an amount credit unions set aside for reserve requirements.

v. The "low balance" method, where credit unions pay dividends on the lowest balance in the account for any day in that period.

2. *Use of 365-day basis.* Credit unions may apply a daily periodic rate that is greater than 1/365 of the dividend rate—such as 1/360 of the dividend rate—as long as it is applied 365 days a year.

3. *Periodic dividend payments.* A credit union can pay dividends each day on the account and still make uniform dividend payments. For example, for a one-year term share account, a credit union could make monthly dividend payments that are equal to 1/12 of the amount of dividends that will be earned for a 365-day period (or 11 uniform monthly payments—each equal to roughly 1/12 of the total amount of dividends—and one payment that accounts for the remainder of the total amount of dividends earned for the period).

4. *Leap year.* Credit unions may apply a daily rate of 1/366 or 1/365 of the dividend rate for 366 days in a leap year, if the account will earn dividends for February 29.

5. *Maturity of term share accounts.* Credit unions are not required to pay dividends after term share accounts mature. Examples include:

i. During any grace period offered by a credit union for an automatically renewable term share account, if the member decides during that period not to renew the account.

ii. Following the maturity of nonrollover term share accounts.

iii. When the maturity date falls on a holiday, and the member must wait until the next business day to obtain the funds.

6. *Dormant accounts.* Credit unions must pay dividends on funds in an account, even if inactivity or the infrequency of transactions would permit the credit union to consider the account to be "inactive" or "dormant" (or similar status) as defined by state or other law or the account contract.

7. *Insufficient funds.* Credit unions are not required to pay dividends on checks or share drafts deposited to a member's account that are returned for insufficient funds. If a credit union accrues dividends on a check that it later determines is not good, it may deduct from the accrued dividends any dividends attributed to the proceeds of the returned check. If dividends have already been credited before the credit union determines the item has insufficient funds, the credit union may deduct the amount of the check and associated dividends from the account balance. The amount deducted will not be reflected in the dividend amount and annual percentage yield earned reported for the next period.

8. *Account drawn below par value of a share.* If a member draws his or her account below the par value of a share, dividends would continue to accrue on the account so long as any minimum balance requirement is met. However, under the NCUA Standard FCU Bylaws, if a member who reduces his or her share balance below the value of a par value share and does

not increase the balance within at least six months, the credit union may terminate the member's membership. State-chartered credit unions may have similar termination provisions.

(a)(2) Determination of minimum balance to earn dividends

1. *General.* Credit unions may set minimum balance requirements that must be met in order to earn dividends. However, credit unions must use the same method to determine a minimum balance required to earn dividends as they use to determine the balance upon which dividends will accrue and pay. For example, a credit union that calculates dividends on the daily balance method must use the daily balance method to determine if the minimum balance to earn dividends has been met. Similarly, a credit union that calculates dividends on the average daily balance method must use the average daily balance method to determine if the minimum to earn dividends has been met. Credit unions may have a par value of a share that is different from the minimum balance requirement to earn dividends. (See commentary to § 707.4(b)(3)(i)).

2. *Daily balance accounts.* Credit unions that require a minimum balance to earn dividends may choose not to pay dividends for days when the balance drops below the required minimum balance if they use the daily balance method to calculate dividends. For example, a credit union could set a minimum daily balance level of $200 and pay dividends only those days the $200 daily balance is maintained.

3. *Average daily balance accounts.* Credit unions that require a minimum balance to earn dividends may choose not to pay dividends for the average daily balance calculation period in which the average daily balance drops below the required minimum, if they use the average daily balance method to calculate dividends. For example, a credit union could set a minimum average daily balance level of $200 and pay dividends only if the $200 average daily balance is met for the calculation period.

4. *Beneficial method.* Credit unions may not require members to maintain both a minimum daily balance and a minimum average daily balance to earn dividends, such as by requiring the member to maintain a $500 daily balance and a prescribed average daily balance (whether higher or lower). But a credit union could offer a minimum balance to earn dividends that includes an additional method that is "unequivocally beneficial" to the member such as the following:

i. A credit union using the daily balance method to calculate dividends and requiring a $500 minimum daily balance could choose to pay dividends on the account (for those days the minimum balance is not met) as long as the member maintained an average daily balance throughout the month of $400.

ii. A credit union using the average daily balance method to calculate dividends and requiring a $400 minimum average daily balance could choose to pay dividends on the account as long as the member maintained a daily balance of $500 for at least half of the days in the period.

iii. A credit union using either the daily balance method or average daily balance method to calculate dividends that requires: (A) a $500 daily balance; or (B) a $400 average daily balance to pay dividends on the account.

5. *Paying on full balance.* Credit unions must pay dividends on the full balance in the account that meets the required minimum balance. For example, if $300 is the minimum daily balance required to earn dividends, and a member deposits $500, the credit union must pay the stated dividend rate on the full $500 and not just on $200.

6. *Negative balances prohibited.* Credit unions must treat a negative account balance as zero to determine:

i. The daily or average daily balance on which dividends will be paid.

ii. Whether any minimum balance to earn dividends is met (See commentary to Appendix A, Part II, which prohibits credit unions from using negative balances in calculating the dividends figure for the annual percentage yield earned.)

7. *Club accounts.* Credit unions offering club accounts (such as a "holiday" or "vacation" club accounts) cannot impose a minimum balance requirement for dividends based on the total number or dollar amount of payments required under the club plan. For example, if a plan calls for $10 weekly payments for 50 weeks, the credit union cannot set a $500 minimum balance and then pay only if the member makes all 50 payments.

8. *Minimum balances not affecting dividends.* Credit unions may use the daily balance, average daily balance, or other computation method to calculate minimum balance requirements not involving the payment of dividends—such as to compute minimum balances for assessing fees.

(b) Compounding and crediting policies

1. *General.* Credit unions choosing to compound dividends may compound or credit dividends annually, semi-annually, quarterly, monthly, daily, continuously, or on any other basis.

2. *Withdrawals prior to crediting date.* If members withdraw funds (without closing the account), prior to a scheduled crediting date, credit unions may delay paying the accrued dividends on the withdrawn amount until the scheduled crediting date, but may not avoid paying dividends.

3. *Closed accounts.* Subject to state or other law, a credit union may choose not to pay accrued dividends if members close an account prior to the date accrued dividends are credited, as long as the credit union has disclosed that fact. If accrued dividends are paid, accrued dividends must be paid on funds up until the account is closed or the account is deemed closed. For example, if an account is closed on a Tuesday, accrued dividends on the funds through Monday would be paid. Whether (and the conditions under which) credit unions are permitted to deem an account closed by a member is determined by state or other law, if any. Credit unions are cautioned that bylaw requirements may prevent a credit union from deeming a member's account closed until certain time periods are extinguished. (See NCUA Standard FCU Bylaws, Art. III, 3 (members have at least 6 months to replenish membership share before membership can terminate and the account is deemed closed). Such bylaw requirements may not be overridden without proper agency approval.)

(c) Date dividends begin to accrue

1. *Relation to Regulation CC.* Credit unions may rely on the Expedited Funds Availability Act (EFAA) and Regulation CC (12 CFR part 229) to determine, for example, when a deposit is considered made for purposes of dividend accrual, or when dividends need not be paid on funds because a deposited check is later returned unpaid.

2. *Ledger and collected balances.* Credit unions may calculate dividends by using a "ledger" balance or "collected" balance method, as long as the crediting requirements of the EFAA are met (12 CFR § 229.14).

3. *Withdrawal of principal.* Credit unions must accrue dividends on funds until the funds are withdrawn from the account. For example, if a check is debited to an account on a Tuesday, the credit union must accrue dividends on those funds through Monday.

§ 707.8—Advertising.

(a) Misleading or inaccurate advertisements

1. *General.* All advertisements are subject to the rule against misleading or inaccurate advertisements, even though the disclosures applicable to various media differ. The word "profit" may be used when referring to dividend-bearing share accounts, as it reflects the nature of dividends. The word "profit" may not be used when referring to interest-bearing deposit accounts.

2. *Indoor signs.* An indoor sign advertising an annual percentage yield is not misleading or inaccurate if:

i. For a tiered-rate account, it also provides the upper and lower dollar amounts of the tier corresponding to the advertised annual percentage yield.

ii. For a term share account, it also provides the term required to obtain the advertised annual percentage yield.

3. *"Free" or "no cost" accounts.* For purposes of determining whether an account can be advertised as "free" or "no cost," maintenance and activity fees include:

i. Any fee imposed if a minimum balance requirement is not met, or if the member exceeds a specified number of transactions.

ii. Transaction and service fees that members reasonably expect to be imposed on an account on a regular basis (See comments 4(b)(4)-1 and 2.)

iii. A flat fee, such as a monthly service fee.

iv. Fees imposed to deposit, withdraw or transfer funds, including per-check or per-transaction charges (for example, $.25 for each withdrawal, whether by check, or in person).

4. *Other fees.* Examples of fees that are not maintenance or activity fees include:

i. Fees that are not required to be disclosed under § 707.4(b)(4).

ii. Check printing fees of any type.

iii. Fees for obtaining copies of checks, whether or not the original checks have been truncated or returned to the member periodically.

iv. Balance inquiry fees.

v. Fees assessed against a dormant account.

vi. Fees for using an ATM.

vii. Fees for electronic transfer services that are not required to obtain an account, such as preauthorized transfers or home electronic credit union services.

viii. Stop payment fees and fees for share drafts or checks returned unpaid.

5. *Similar terms.* An advertisement may not use a term such as "fees waived" if a maintenance or activity fee may be imposed because it is similar to the terms "free" or "no cost."

6. *Specific account services.* Credit unions may advertise a specific account service or feature as free as long as no fee is imposed for that service or feature. For example, credit unions offering an account that is free of deposit or withdrawal fees could advertise that fact, as long as the advertisement does not mislead members by implying that the account is free and that no other fee (a monthly service fee, for example) may be charged.

7. *Free for limited time.* If an account (or a specific account service) is free only for a limited period of time—for example, for one year following the account opening—the account (or service) may be advertised as free as long as the time period is stated.

8. *Conditions not related to share accounts.* Credit unions may advertise accounts as "free" for members that meet conditions not related to share accounts, such as the member's age. For example, credit unions may advertise a share draft account as "free for persons over 65 years old," even though a maintenance or activity fee may be assessed on accounts held by members that are 65 or younger.

(b) Permissible rates

1. *Tiered-rate accounts.* An advertisement for a tiered-rate account that states an annual percentage yield must also state the annual percentage yield for each tier, along with corresponding minimum balance requirements. Any dividend rates stated must appear in conjunction with the annual percentage yields for each tier.

2. *Stepped-rate accounts.* An advertisement that states a dividend rate for a stepped-rate account must state all the dividend rates and the time period that each rate is in effect.

3. *Representative examples.* An advertisement that states an annual percentage yield for a type of account (such as a term share account for a specified term) need not state the annual percentage yield applicable to every variation offered by the credit union or indicate that other maturity terms are available. In an advertisement stating that rates for an account may vary depending on the amount of the initial deposit or the term of a term share account, credit unions need not list each balance level and term offered. Instead, the advertisement may:

i. Provide a representative example of the annual percentage yields offered, clearly described as such. For example, if a credit union offers a $25 bonus on all term share accounts and the annual percentage yield will vary depending on the term selected, the credit union may provide a disclosure of the annual percentage yield as follows: "For example, our 6-month share certificate currently pays a 3.15% annual percentage yield."

ii. Indicate that various rates are available, such as by stating short-term and longer-term maturities along with the applicable annual percentage yields. "We offer share certificates with annual percentage yields that depend on the maturity you choose. For example, our one-month share certificate earns a 2.75% APY. Or, earn a 5.25% APY for a three-year share certificate."

(c) When additional disclosures are required

1. *Trigger terms.* The following are examples of information stated in advertisements that are not "trigger" terms:

i. "One, three, and five year share certificates available".

ii. "Bonus rates available".

iii. "1% over our current rate," so long as the rates are not determinable from the advertisement.

(c)(2) Time annual percentage yield is offered

1. *Specified recent date.* If an advertisement discloses an annual percentage yield as of a specified date, that date must be recent in relation to the publication or broadcast frequency of the media used. For example, the printing date of a brochure printed once for an account promotion that will be in effect for six months would be considered "recent," even though rates change during the six-month period. Dividend rates published in a daily newspaper or on television must be a rate offered shortly before (or on) the date the rates are published or broadcast. Similarly, dividend rates published in a daily newspaper or on television must be a rate reflecting either the preceding dividend period, or a prospective rate, and the option chosen should be noted.

2. *Reference to date of publication.* An advertisement may refer to the annual percentage yield as being accurate as of the date of

publication, if the date is on the publication itself. For instance, an advertisement in a periodical may state that a rate is "current through the date of this issue," if the periodical shows the date.

(c)(5) Effect of fees

1. *Scope.* This requirement applies only to maintenance or activity fees as described in paragraph 8(a).

(c)(6) Features of term share accounts

(c)(6)(i) Time requirements

1. *Club accounts.* If a club account has a maturity date, but the term may vary depending on when the account is opened, credit unions may use a phrase such as: "The maturity date of this club account is November 15; its term varies depending on when the account is opened."

(c)(6)(ii) Early withdrawal penalties

1. *Discretionary penalties.* Credit unions imposing early withdrawal penalties on a case-by-case basis may disclose that they "may" (rather than "will") impose a penalty if that accurately describes the account terms.

(d) Bonuses

1. *General reference to "bonus."* General statements such as "bonus checking" or "get a bonus when you open a checking account" do not trigger the bonus disclosures.

(e) Exemption for certain advertisements

(e)(1) Certain media

(e)(1)(i)

1. *ATM messages.* Messages provided on ATM or computer screens are eligible for this exemption.

(e)(1)(iii)

1. *Tiered-rate accounts.* Solicitations for tiered-rate accounts made through telephone response machines must provide all annual percentage yields and the balance requirements applicable to each tier.

(e)(2) Indoor signs

(e)(2)(i)

1. *General.* Indoor signs include advertisements displayed on computer screens, banners, preprinted posters, and chalk or peg boards. Any advertisement inside the premises that can be retained by a member (such as a brochure or a printout from a computer) is not an indoor sign.

2. *Members outside the premises.* Advertisements may be "indoor signs" even though they may be viewed by members from outside. An example is a banner in a credit union's glass-enclosed branch office, that is located behind a teller facing members but is readable by passersby.

(e)(3) Newsletters

1. *General.* The partial exemption applies to all credit union newsletters, whether instituted before or after the compliance date of part 707. Nor must a newsletter be of any particular circulation frequency (e.g., weekly, monthly, quarterly, biannually, annually, or irregularly) or of any certain format (e.g. magazine, bulletin, broadside, circular, mimeograph, letter, or pamphlet) in order to be eligible for the partial advertising exemption.

2. *Permissible Distribution.* In order for newsletters to retain the partial advertising exemption, newsletters can be sent to existing credit union members only. Any distribution reasonably calculated to reach only members is also acceptable, such as:

i. Mailing newsletters to existing members.

ii. Distributing newsletters at a function reasonably limited to members, such as an annual meeting or member picnic.

iii. Displaying or offering newsletters at a credit union lobby, branch, or office.

3. *Impermissible Distribution.* Distributing a newsletter in a place open to nonmembers, such as a sponsor's lunch room, is not reasonably calculated to reach only members, and such newsletter would be subject to all applicable advertising rules.

§ 707.9—Enforcement and record retention.

(c) Record retention

1. *Evidence of required actions.* Credit unions comply with the regulation by demonstrating they have done the following:

i. Established and maintained procedures for paying dividends and providing timely disclosures as required by the regulation, and.

ii. Retained sample disclosures for each type account offered to members, such as account-opening disclosures, copies of advertisements, and change-in-term notices; and information regarding the dividend rates and annual percentage yields offered.

2. *Methods of retaining evidence.* Credit unions must be able to reconstruct the required disclosures or other actions. They need not keep disclosures or other business records in hard copy. Records evidencing compliance may be retained on microfilm, microfiche, or by other methods that reproduce records accurately (including computer files). Credit unions must

retain copies of all printed advertisements and the text of all advertisements conveyed by electronic or broadcast media, and newsletters.

3. *Payment of dividends.* Credit unions must retain sufficient rate and balance information to permit the verification of dividends paid on an account, including the payment of dividends on the full principal balance.

Appendix A to Part 707—Annual Percentage Yield Calculation

Part I. Annual percentage yield for account disclosures and advertising purposes.

1. *Rounding for calculations.* The following are examples of permissible rounding rules for calculating dividends and the annual percentage yield:

i. The daily rate applied to a balance carried to five or more decimals. For example: .008219178%, 3.00% for a 365 day year, would be rounded to no less than .00822%.

ii. The daily dividends or interest earned carried to five or more decimals. For example; $.08219178082, daily dividends on $1,000 at 3% for a 365 day year, would be rounded to no less than $.08219.

2. *Exponents in a leap year.* The annual percentage yield formula's exponent numerator will remain 365 in leap years. The "days in term" figure used in the denominator should be consistent with the length of term used in the dividends calculation.

3. *First tier of a tiered-rate account.* When credit unions use a rate table, the first tier of a tiered rate account is to be disclosed and advertised: "Up to but not exceeding . . .", "$.01 to . . .", or similar language.

4. *Term share accounts opened in midterm.* For club accounts that meet the definition of a term share account, the annual percentage yield is based on the maximum number of days in the term not to exceed 365 days (or 366 days in a leap year).

Part II. Annual percentage yield earned for periodic statements.

1. *Balance method.* The dividend or interest figure used in the calculation of the annual percentage yield earned may be derived from the daily balance method or the average daily balance method. Regardless of the dividend calculation method, the balance used in the annual percentage yield earned formula is the average daily balance. The average daily balance calculation is the sum of the balances for each day in the period divided by the number of days in the period. The balance for each day is based on a point in time; i.e. beginning of day balance, end of day balance, closing of day balance, etc. Each day's balance, for dividend accrual and payment purposes, must be based on the same point in time and cannot be based on the day's low balance.

2. *Negative balances prohibited.* Credit unions must treat a negative account balance as zero to determine the balance on which the annual percentage yield earned is calculated. (See commentary to § 707.7(a)(2).)

A. General formula.

1. *Accrued but uncredited dividends.* To calculate the annual percentage yield earned, accrued but uncredited dividends:

i. May not be included in the balance for statements that are issued at the same time or less frequently than the account's compounding and crediting frequency. For example, if monthly statements are sent for an account that compounds dividends daily and credits dividends monthly, the balance may not be increased each day to reflect the effect of daily compounding. Assume a credit union will pay $13.70 in dividends on $100,000 for the first day, $6.85 in dividends on $50,013.70 for the second day, and $3.43 in dividends on $25,020.55 for the third day. The sum of each day's balance is $175,000 (does not include accrued, but uncredited, dividends amounts $13.70, $6.85, and $3.43), thereby resulting in an average daily balance for the three days of $58,333.33.

ii. Must be included in the balance for succeeding statements if a statement is issued more frequently than compounded dividends are credited on an account. For example, if monthly statements are sent for an account that compounds dividends daily and credits dividends quarterly, the balance for the second monthly statement would include dividends that had accrued for the prior month. Assume a credit union will pay $411.78 in dividends on 30 days of $100,000, $427.28 in dividends on 31 days of $100,411.78, and $415.23 in dividends on 30 days of $100,839.06. The balance (average daily

balance in the account for the period) for the second 31 days is $100,411.78.

2. *Rounding.* The dividends earned figure used to calculate the annual percentage yield earned must be rounded to two decimals to reflect the amount actually paid. For example, if the dividends earned for a statement period is $20.074 and the credit union pays the member $20.07, the credit union must use $20.07 (not $20.074) to calculate the annual percentage yield earned. For accounts that pay dividends based on the daily balance method, compound and credit dividends or interest quarterly, and send monthly statements, the credit union may, but need not, round accrued dividends to two decimals for calculating the "projected" or "anticipated" annual percentage yield earned on the first two monthly statements issued during the quarter. However, on the quarterly statement the dividends earned figure must reflect the amount actually paid.

3. *Compounding frequency using the average daily balance method.* Any compounding frequency, including daily compounding, can be used when calculating dividends using the average daily balance method. (See comment § 707.7(b), which does not require credit unions to compound or credit dividends at any particular frequency).

B. Special formula for use where periodic statement is sent more often than the period for which dividends are compounded.

1. *Statements triggered by Regulation E.* Credit unions may, but need not, use this formula to calculate the annual percentage yield earned for accounts that receive quarterly statements and that are subject to Regulation E's rule calling for monthly statements when an electronic fund transfer has occurred. They may do so even though no monthly statement was issued during a specific quarter. This formula must be used for accounts that compound and credit dividends quarterly and that receive monthly statements, triggered by Regulation E, which comply with the provisions of § 707.6.

2. *Days in compounding period.* Credit unions using the special annual percentage yield earned formula must use the actual number of days in the compounding period.

Appendix B to Part 707—Model Clauses and Sample Forms

1. *Modifications.* Credit unions that modify the model clauses will be deemed in compliance as long as they do not delete information required by TISA or regulation or rearrange the format so as to affect the substance or clarity of the disclosures.

2. *Format.* Credit unions may use inserts to a document (see Sample Form B–11) or fill-in blanks (see Sample Forms B–4 and B–5, which use double underlining to indicate terms that have been filled in) to show current rates, fees or other terms.3. Disclosures for opening accounts. The sample forms illustrate the information that must be provided to a member when an account is opened, as required by § 707.4(a)(1). (See § 707.4(a)(2), which states the requirements for disclosing the annual percentage yield, the dividend rate, and the maturity of a term share account in responding to a member's request.)

4. *Compliance with Regulation E.* Credit unions may satisfy certain requirements under Part 707 with disclosures that meet the requirements of Regulation E. (See § 707.3(c).) The model clauses and sample forms do not give examples of disclosures that would be covered by both this regulation and Regulation E (such as disclosing the amount of a fee for ATM usage). Credit unions should consult appendix A to Regulation E for appropriate model clauses.

5. *Duplicate disclosures.* If a requirement such as a minimum balance applies to more than one account term (to obtain a bonus and determine the annual percentage yield, for example), credit unions need not repeat the requirement for each term, as long as it is clear which terms the requirement applies to.

6. *Guide to model clauses.* In the model clauses, italicized words indicate the type of disclosure a credit union should insert in the space provided (for example, a credit union might insert "March 25, 1995" in the blank for "(date)" disclosure). Brackets and diagonals ("/") indicate a credit union must choose the alternative that describes its practice (for example, [daily balance/average daily balance]).

7. *Sample forms.* The sample forms (B–4 through B–11) serve a purpose different from the model clauses. They illustrate various ways of adapting the model clauses to specific accounts. The clauses shown relate only to the specific transactions described.

Part 708a

Mergers or Conversions of Federally-Insured Credit Unions to Non Credit Union Status: NCUA Approval

§ 708a.1 NCUA Board Approval.

Section 205(b)(1) of the Federal Credit Union Act requires NCUA Board approval in advance of any transaction whereby a federally-insured credit union transfers all or any part of its members' accounts to any non credit union institution. This part establishes rules and procedures for any merger, conversion or other transaction in which a federally-insured credit union's share accounts or similar member accounts are transferred to a non credit union institution. Transactions where a federally- insured credit union transfers member accounts to another credit union are subject to the provisions of part 708b of this chapter. Compliance with this part 708a is in addition to any other federal or state laws and regulations which may be applicable to the proposed transaction, including state corporate laws and state and federal securities laws.

§ 708a.2 Plan for Merger or Conversion to a Non Credit Union Institution.

(a) *Proposition for merger or conversion.* The board of directors of the credit union shall approve a proposition for merger or conversion.

(b) *Plan for merger or conversion.* Upon approval of a proposition for merger or conversion by the board of directors, a plan for the transaction shall be prepared. The plan shall include:

(1) current financial reports;

(2) current delinquent loan schedules annotated to reflect collection problems;

(3) combined financial report, if applicable;

(4) contingencies;

(5) explanation of any provisions for reserves, undivided earnings or dividends;

(6) analyses of share values and explanation of any adjustments to member's share accounts;

(7) analyses of the regulatory effect of the merger or conversion brought about by the change in government regulator;

(8) explanation of any other relevant effects on the members; and

(9) any additional information, as required by the NCUA Regional Director.

(c) *Nonpreferential treatment.* The plan for merger or conversion shall provide that, for a period of at least two years after the effective date of the transaction:

(1) no director of the credit union may receive any compensation or any benefits not provided or available to other members; and

(2) no director or senior management official of the credit union shall be allowed to acquire stock in the resulting or continuing institution or any successor institution, on any terms other than those readily available to all members of the former credit union. This prohibition would include stock issued for services rendered prior to the merger or conversion. For purposes of this section, "senior management official" means the credit union's chief executive officer, any assistant chief executive officers and the chief financial officer.

§ 708a.3 Submission of proposal to NCUA.

(a) *Submissions to the NCUA Regional Director.* Upon approval of the plan by the board of directors of the credit union, the following will be submitted to the appropriate NCUA Regional Director:

(1) the plan, as described in § 708a.2(b) of this part;

(2) a resolution of the board of directors approving the plan;

(3) a written agreement from each member of the board of directors and each senior management official to comply with the terms of § 708a.2(c) (the agreement shall be executed by NCUA as well, in the event of approval of the transaction);

(4) a proposed merger or conversion agreement;

(5) a proposed Notice of Meeting, as described in Appendix A of this part;

(6) a copy of the form ballot and any accompanying materials to be sent to the members, as described in Appendix A of this part;

(7) a complete copy of the package [to be] submitted to any other regulatory agencies involved in the merger or conversion;

(8) a copy of an appraisal of the value of the credit union, if the proposal is to convert or merge the credit union either directly or indirectly into a stock institution, and any plan for sale or distribution of stock to the credit union's members, officials and employees; and

(9) in the case of a federally-insured state chartered credit union, evidence that the state supervisory authority is in agreement with the merger or conversion proposal.

(b) *Coordination with State Supervisory Authority.* In the event the proposal is filed with the NCUA prior to receiving consent from the state supervisory authority:

(1) the Board will coordinate with the state supervisory authority; and

(2) the Board will not approve any merger or conversion unless it is approved by the state supervisory authority.

(c) *Waiver of NCUA rules and approval by state supervisory authority.* A federally-insured state credit union may, on a case-by-case basis, request a waiver of this part 708a from the Board and receive authority to proceed under state rules and procedures. In making such a request, the credit union shall demonstrate that the concerns underlying this part 708a are adequately addressed and, in particular that:

(1) proceeding under state rules present no financial risk to the credit union or the NCUSIF;

(2) adequate safeguards exist against breach of duty by, or preferential treatment of directors, committee members and others involved in the transaction; and

(3) the transaction is otherwise fair to members and carried out pursuant to an informed and decisive membership vote.

§ 708a.4 Approval of Proposal by NCUA.

If NCUA finds that the proposal complies with the provisions of this part and does not present an undue risk to the NCUSIF or unduly prejudice the members, it may approve the proposal subject to such other specific requirements as may be prescribed to fulfill the stated purposes of the proposal. No proposal will be approved that does not *clearly* inform the members of the fundamental rights they would be giving up if their credit union converts or merges into a non credit union institution.

§ 708a.5 Approval of Proposal by Members.

(a) *Notification of members.* The members shall:

(1) Have the option of voting on the proposal either in person at a membership meeting or by mail ballot.

(2) Be given advance notice of the membership meeting in accordance with the provisions of Appendix A of this part. The notice shall be delivered in person to each member, or mailed to each member at the address for such member as it appears on the records of the credit union, not more than 30 days nor less than 14 days prior to the date for the vote. The ballot to be used for the membership vote shall be in accordance with the provisions of Appendix A of this part. The notice and ballot shall be provided to the members at the same time. If applicable, the notice and ballot shall be provided in both English as well as the native language of the majority of the members.

(3) Be made aware that the complete application and proposal are available for inspection at the credit union's branch offices during normal business hours.

(b) *Vote by members.* The proposal must be approved by the affirmative vote of a majority of the credit union's members.

(c) *Notice of approval to members.* If the proposal for merger or conversion is approved by the membership and the NCUA Board, prompt and reasonable notice shall be given to all members.

§ 708a.6 Certification and Completion of Merger or Conversion.

(a) *Certification of vote.* The board of directors shall certify the results of the membership vote to the Regional Director within 10 days after the vote is taken.

(b) *Completion.* Upon approval of the proposal by NCUA, the state supervisory authority (where the credit union is state chartered), the members and any federal agency with approval or regulatory authority for the transaction, the credit union may complete the merger or conversion.

(c) *Certification of completion.* Within 30 days after the effective date of the merger or conversion,

the board of directors of the continuing institution shall certify the completion of the transaction to the Regional Director.

(d) *Cancellation of charter and insurance.* Upon NCUA's receipt of certification that the transaction has been completed, the charter of the federal credit union (if applicable) and the insurance certificate of the federally insured credit union will be canceled.

Appendix A to Part 708a—Notice to Members of Special Meeting, Disclosure and Ballot

(1) The Notice of Special Meeting must include the following:

(a) the date, time and place of the Meeting;

(b) a description of the matters to be voted upon at the Special Meeting;

(c) a statement in a prominent location in bold letters that **"A DISCLOSURE STATEMENT HAS BEEN PROVIDED TO YOU WITH THIS NOTICE OF SPECIAL MEETING. THE DISCLOSURE MUST BE READ BEFORE VOTING ON THE PROPOSED ("CONVERSION"** or **"MERGER",** as appropriate)", and

(d) a statement that a Mail Ballot for the Special Meeting is enclosed.

(2) The Disclosure provided with the Notice must at a minimum provide the following information to the members:

(a) Factual information about the credit union, i.e. name and address of credit union and telephone number of contact person;

(b) Summary of the proposal which shall contain but not necessarily be limited to current financial reports for the credit union and the other institution if a merger is proposed; a projected financial report for the continuing institution; analyses of share values; an explanation of any proposed share adjustments; and an explanation of any changes relative to insurance such as insurance of member accounts and life savings and loan protection insurance.

(c) Summary of the direct and indirect benefits to the credit union members, as well as any disadvantages, including a clear explanation of the nature of the change in the members' ownership interest in the reserves and undivided earnings of the credit union as a result of the merger or conversion;

(d) Summary of the direct and indirect benefits to management and other key persons at the credit union and at the new institution, including a comparison of salaries for those individuals employed by both the credit union and the new institution; copies of the certifications from the directors and committee members that they will receive no compensation either directly or indirectly from the new institution for a period of two years; and disclosure of any relationship by blood or marriage, of any of the officers, directors, key personnel or principal stockholders of the proposed institution to any officials or employees of the credit union.

(e) For each director, officer, key employee and consultant of the proposed institution, state in detail the names, positions, addresses, age and description of employment and educational background. Include any petitions for bankruptcy, civil judgments (indicate the plaintiff and the amount of the judgment), criminal conviction (indicate the nature of the charge) and any administrative action taken by a federal or state agency.

(f) Description of how the proposed merger/conversion results in a new financial institution *without* the unique characteristics of a credit union, for example, that the board of directors (that is, any new board members, since § 708a.2(c) prohibits compensation for a period of 2 years) may be compensated as officials instead of offering volunteer services, that the credit union will lose its tax exempt status, and any changes in the voting power of members.

(g) A dollar expenditure comparison chart of the estimated increases/decreases in regulatory and insurance fees;

(h) Itemized expenses incurred to date in the conversion process with an estimate as to future expenses;

(i) Management's discussion and analysis of the proposed conversion, including its economic advisability and how it will serve the needs of the members of the merging or converting credit union;

(j) Business and properties of the proposed institution - describe in detail the assets of the credit union and whether these assets will be transferred to the proposed institution and how

the members will or will not benefit from the transfer;

(k) Description and comparison of the competition of the proposed institution and why the proposed institution believes it can effectively compete;

(l) In any transaction where the new or resulting institution is a stock institution, identify the principal owners of the proposed stock institution (those who will beneficially own directly or indirectly 1% or more of the common and preferred stock outstanding) starting with the largest common stockholder. Indicate by footnote if the price paid was for a consideration other than cash and the nature of any such consideration. Indicate the number of shares to be individually owned by officers, directors and key personnel of the new institution; and

(m) State in bold on the cover **"PLEASE READ THIS DISCLOSURE DOCUMENT. IT CONTAINS IMPORTANT INFORMATION ABOUT YOUR CREDIT UNION."**

(3) The Mail Ballot must:

(a) state at the top in bold letters using 12 point pitch or greater that **"THE ATTACHED DISCLOSURE STATEMENT MUST BE READ BEFORE VOTING ON THE PROPOSED ("CONVERSION"** or **"MERGER",** as appropriate)";

(b) the issues for the member to vote on should be stated as follows:

Please vote for either (a) or (b) by checking the appropriate box.

(a) Approve the merger ☐
(b) Disapprove the merger ☐

(c) advise the member of the right to terminate the mail ballot and attend and vote at the Special Meeting.

Part 708b

Mergers of Federally-Insured Credit Unions; Voluntary Termination or Conversion of Insured Status

§ 708b.0 Scope.

(a) Subpart A of this Part prescribes the procedures for merging one or more credit unions with a continuing credit union where at least one of the credit unions is federally insured.

(b) Subpart B of this Part prescribes the procedures and notice requirements for termination of Federal insurance or conversion of Federal insurance to nonfederal insurance, including termination or conversion resulting from a merger.

(c) Subpart C of this Part sets forth the forms to be used for terminating Federal insurance or converting from Federal insurance to nonfederal insurance.

(d) Nothing in this Part shall operate as a restriction or otherwise impair the authority of NCUA to approve a merger pursuant to Section 205(h) of the Act.

(e) This Part does not address procedures or requirements that may be applicable under state law for a state credit union.

§ 708b.1 Definitions.

(a) "Continuing credit union" means the credit union which will continue in operation after the merger.

(b) "Merging credit union" means the credit union which will cease to exist as an operating credit union at the time of the merger.

(c) "State credit union" means any credit union organized and operated according to the laws of any state, the several territories and possessions of the United States, or the Commonwealth of Puerto Rico. Accordingly, "state authority" means the appropriate state or territorial regulatory or supervisory authority for any such credit union.

(d) "Federally-insured" means insured by the Board through the National Credit Union Share Insurance Fund (NCUSIF).

(e) "Nonfederally-insured" means insured by a private or cooperative insurance fund or guaranty corporation organized or chartered under state law.

(f) "Uninsured" means there is no share or deposit insurance available on the credit union accounts.

(g) The terms "terminate," "termination" and "terminating," when used in reference to insurance, refer to the act of canceling Federal insurance and mean that the credit union will become uninsured.

(h) The terms "convert," "conversion" and "converting," when used in reference to insurance, refer to the act of canceling Federal insurance and simultaneously obtaining share or deposit insurance from another insurance carrier. They mean that after cancellation of Federal insurance the credit union will be nonfederally insured.

Subpart A—Mergers

§ 708b.101 Mergers generally.

(a) In any case where a merger will result in the termination of Federal insurance or conversion to nonfederal insurance, the merging credit union must comply with the provisions of Subpart B in addition to this Subpart A.

(b) No federally-insured credit union shall merge with any other credit union without the prior written approval of the Board.

(c) Where the continuing credit union is a Federal credit union, there must be compliance with the chartering policies of the Board.

(d) Where the continuing or merging credit union is a state credit union, the merger must be permitted by state law or authorized by the state authority.

§ 708b.102 Special provisions for Federal insurance.

(a) Where the continuing credit union is federally insured, an NCUSIF deposit and a prorated insurance premium (unless waived in whole or in part for all insured credit unions during that year) will be assessed on the additional share accounts insured as a result of the merger of a nonfederally-insured or uninsured credit union with a federally-insured credit union.

(b) Where the continuing credit union is nonfederally insured or uninsured but desires to be federally insured as of the date of the merger, an application shall be submitted to the appropriate Regional Director when the merging credit union requests approval of the merger proposal. An NCUSIF deposit and a prorated insurance premium (unless waived in whole or in part for all insured credit unions during that year) will be assessed on any additional share accounts insured as a result of the merger.

(c) Where the continuing credit union is nonfederally insured or uninsured and does not make application for insurance, but the merging credit union is federally insured, the continuing credit union is entitled to a refund of the merging credit union's NCUSIF deposit and to a refund of the unused portion of the NCUSIF share insurance premium (if any). If the continuing credit union is uninsured, the refund will be made only after expiration of the one-year period of continued insurance coverage noted in subsection (e) of this section.

(d) Where the continuing credit union is nonfederally-insured, NCUSIF insurance of the member accounts of a merging federally-insured credit union ceases as of the effective date of the merger. (Refer to Subpart B, §§ 708b.203 and 708b.204 and Subpart C, § 708b.302(b).)

(e) Where the continuing credit union is uninsured, NCUSIF insurance of the member accounts of the merging federally-insured credit union will continue for a period of one year, subject to the restrictions in Section 206(d)(1) of the Act as noted in the Notice of Termination set forth in § 708b.301(b)(3). (Refer to Subpart B, §§ 708b.201 and 708b.202, and Subpart C, § 708b.301(b).)

§ 708b.103 Preparation of merger plan.

(a) Upon the approval of a proposition for merger by the boards of directors of the credit unions, a plan for the proposed merger shall be prepared. The plan shall include:

(1) current financial reports;

(2) current delinquent loan schedules annotated to reflect collection problems;

(3) combined financial report;

(4) analyses of share values;

(5) explanation of any proposed share adjustments;

(6) explanation of any provisions for reserves, undivided earnings or dividends;

(7) provisions with respect to notification and payment of creditors;

(8) explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts;

(9) provisions for determining that all assets and liabilities of the continuing credit union will conform with the requirements of the Act (where the continuing credit union is a Federal credit union); and

(10) proposed charter amendments (where the continuing credit union is a Federal credit union). These amendments, if any, will usually pertain to the name of the credit union and the definition of its field of membership.

§ 708b.104 Submission of merger proposal to NCUA.

(a) Upon approval of the merger plan by the boards of directors of the credit unions, the following information will be submitted to the Regional Director:

(1) the merger plan, as described in this Part;

(2) resolutions of the boards of directors;

(3) proposed Merger Agreement;

(4) proposed Notice of Special Meeting of the Members (for merging Federal credit unions);

(5) copy of the form of Ballot to be sent to the members (for merging Federal credit unions);

(6) evidence that the state's supervisory authority is in agreement with the merger proposal (for states which require such agreement prior to NCUA approval); and

(7) Application and Agreement for Insurance of Member Accounts (for continuing state credit unions desiring to become federally insured).

§ 708b.105 Approval of merger proposal by NCUA.

(a) In any case where the continuing credit union is federally insured, and the merging credit union is nonfederally insured or uninsured, a determination shall be made by NCUA as to the potential risk to the National Credit Union Share Insurance Fund (NCUSIF).

(b) If NCUA finds that the merger proposal complies with the provisions of this Part and does

not present an undue risk to the NCUSIF, it may approve the proposal subject to such other specific requirements as may be prescribed to fulfill the intended purposes of the proposed merger. In the event NCUA determines that the merging credit union, if it is a Federal credit union, is in danger of insolvency, and that the proposed merger would reduce the risk or avoid a threatened loss to the National Credit Union Share Insurance Fund, NCUA may permit the merger to become effective without an affirmative vote of the membership of the merging Federal credit union, notwithstanding the provisions of Section 708b.106; *Provided* that the continuing credit union is federally insured.

(c) Any proposed charter amendments for a continuing Federal credit union will be approved contingent upon the completion of the merger.

§ 708b.106 Approval of the merger proposal by members.

(a) When the merging credit union is a Federal credit union, the members shall:

(1) Have the right to vote on the merger proposal in person at the annual meeting, if within 60 days after NCUA approval, or at a special meeting to be called within 60 days of such approval, or by mail ballot, received no later than the date and time announced for the annual meeting or the special meeting called for that purpose.

(2) Be given advance notice of the meeting at which the merger proposal is to be submitted, in accordance with the provisions of Article V, Meetings of Members, Federal Credit Union Bylaws. The notice shall:

(i) specify the purpose of the meeting and the time and place;

(ii) include a summary of the merger plan, which shall contain, but not necessarily be limited to, current financial reports for each credit union, a combined financial report for the continuing credit union, analyses of share values, explanation of any proposed share adjustments, explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts (refer to Subpart B, §§ 708b.202 and 708b.204);

(iii) state reasons for the proposed merger;

(iv) provide name and location (to include branches) of the continuing credit union;

(v) inform the members that they have the right to vote on the merger proposal in person at the meeting or by written ballot to be received no later than the date and time announced for the annual meeting or the special meeting called for that purpose; and

(vi) be accompanied by a Ballot for Merger Proposal.

(b) The proposal to merge a Federal credit union into a federally-insured credit union must be approved by an affirmative vote of a majority of the members of the merging credit union who vote on the proposal. If the continuing credit union is uninsured, the voting requirements of § 708b.201(c) apply; if it is nonfederally insured, the voting requirements of § 708b.203(c) apply.

§ 708b.107 Certificate of vote on merger proposal.

The board of directors of the merging Federal credit union shall certify the results of the membership vote to the Regional Director within 10 days after the vote is taken.

§ 708b.108 Completion of merger.

(a) Upon approval of the merger proposal by NCUA and by the state supervisory authority (where the continuing or merging credit union is a state credit union) and by the members of each credit union where required, action may be taken to complete the merger.

(b) Upon completion of the merger, the board of directors of the continuing credit union shall certify the completion of the merger to the Regional Director within 30 days after the effective date of the merger.

(c) Upon NCUA's receipt of certification that the merger has been completed, then the charter of the merging Federal credit union (if applicable) and the insurance certificate of any merging federally-insured credit union will be canceled.

Subpart B—Voluntary Termination or Conversion of Insured Status

§ 708b.201 Termination of insurance.

(a) A state credit union may terminate Federal insurance, if permitted by state law, either on its own or by merging into an uninsured credit union.

(b) A Federal credit union may terminate Federal insurance only by merging into, or converting its charter to, an uninsured state credit union.

(c) Termination of insurance must be approved by the affirmative vote of a majority of the credit union's members. The credit union must notify the Board, through the Regional Director, in writing at least 90 days prior to termination and the membership vote must have been obtained within one year prior to giving the Board notice.

(d) No federally-insured credit union shall terminate Federal insurance without the prior written approval of the Board. The Board will approve or disapprove the termination in writing within 90 days after being notified by the credit union.

§ 708b.202 Notice to members of termination of insurance.

(a) When a federally-insured credit union proposes to terminate Federal insurance, including termination due to a merger or conversion of charter, it shall provide its members with written notice of the proposal to terminate and of the date set for the membership vote. The Notice of Proposal shall be as set forth in either § 708b.301 (a)(1) or (b)(1), or as provided in § 708b.301(c), as the circumstances warrant.

(b) The notice shall be delivered in person to each member, or mailed to each member at the address for such member as it appears on the records of the credit union, not more than 30 nor less than 7 days prior to the date of the vote. The membership shall be given the opportunity to vote by mail ballot. The ballot to be used shall be as set forth in either § 708b.301 (a)(2) or (b)(2), as the circumstances warrant. The notice of the proposal and the ballot may be provided to members at the same time.

(c) If the proposition for termination of insurance is approved by the membership and the Board, prompt and reasonable notice of termination shall be given to all members in the form set forth in either § 708b.301 (a)(3) or (b)(3), as the circumstances warrant.

§ 708b.203 Conversion of insurance.

(a) A federally-insured state credit union may convert to nonfederal insurance, if permitted by state law, either on its own or by merging into a nonfederally-insured credit union.

(b) A Federal credit union may convert to nonfederal insurance only by merging into, or converting its charter to, a nonfederally-insured state credit union.

(c) Conversion of Federal to nonfederal insurance must be approved by an affirmative vote of a majority of the credit union's members who vote on the proposition, provided at least 20 percent of the total membership participates in the voting. The credit union must notify the Board, through the Regional Director, in writing at least 90 days prior to conversion. Notice to the Board may be given when membership approval is solicited or after membership approval is obtained.

(d) No federally-insured credit union shall convert to nonfederal insurance without the prior written approval of the Board. The Board will approve or disapprove the conversion in writing within 90 days after being notified by the credit union.

§ 708b.204 Notice to members of conversion of insurance.

(a) When a federally-insured credit union proposes to convert to nonfederal insurance, including conversion due to a merger or conversion of charter, it shall provide its members with written notice of the proposal to convert and of the date set for the membership vote. Notice of the proposal shall be as set forth in either § 708b.302 (a)(1) or (b)(1), or as provided in § 708b.302(c), as the circumstances warrant.

(b) The notice shall be delivered in person to each member, or mailed to each member at the address for such member as it appears on the records of the credit union, not more than 30 nor less than 7 days prior to the date for the vote. The membership shall be given the opportunity to vote by mail ballot. The ballot to be used for the membership vote shall be as set forth in either § 708b.302 (a)(2) or (b)(2), as the circumstances warrant. The notice of the proposal and the ballot may be provided to the members at the same time.

(c) If the proposition for conversion of insurance is approved by the membership and the Board, prompt and reasonable notice shall be given to all members in the form set forth in either § 708b.302 (a)(3) or (b)(3), as the circumstances warrant.

Subpart C—Forms

§ 708b.301 Termination of insurance.

(a) A federally-insured state credit union shall use the following language for purposes of terminating Federal insurance:

(1) Notice of Proposal to Terminate Federal Insurance

_____(Date)

The Board of Directors of _____ Credit Union has approved a proposition to terminate Federal share (deposit) insurance ($100,000, provided by the National Credit Union Administration (NCUA), an agency of the Federal Government). Termination of Federal insurance may only take place upon approval by a majority of our members. The membership vote will be taken on date. (Add directions regarding membership meeting and/or mail ballot.)

If approved, any deposits made by you after the date of termination, either new deposits or additions to existing accounts, will not be insured by the NCUA.

Accounts in the Credit Union on the day of termination, up to a maximum of $100,000 for each member, will continue to be insured, as provided in the Federal Credit Union Act, for one (1) year after the close of business on the day of termination, but any withdrawals after the close of business on that date will reduce the insurance coverage by the amount of the withdrawal.

(2) The ballot for obtaining membership approval to terminate Federal insurance shall contain the following language:

This ballot must be received by the Credit Union by _____ (date for vote)

I understand that if termination of Federal insurance is approved, any new deposits or additions to existing accounts made by me will not be insured by the National Credit Union Administration, an agency of the Federal Government. I also understand that my accounts in the Credit Union on the date of termination, up to a maximum of $100,000, will continue to be insured for one (1) year after the date of termination, but that any withdrawals after the date of termination will reduce the insurance coverage by the amount of the withdrawal.

[ ] Approve termination of insurance.

[ ] Do not approve termination of insurance.

Signed _____
Member's Name

Date _____

(3) *Notice of Termination*

_____

1. The status of the _____ as an insured credit union under the provisions of the Federal Credit Union Act will terminate as of the close of business on the _____ day of _____.
2. Any deposits made by you after that date, either new deposits or additions to existing accounts, will not be insured by the National Credit Union Administration.
3. Accounts in the Credit Union on the _____ day of _____, up to a maximum of $100,000 for each member, will continue to be insured, as provided by the Federal Credit Union Act, for one (1) year after the close of business on the _____ day of _____; Provided, however, that any withdrawals after the close of business on the day of _____, will reduce the insurance coverage by the amount of such withdrawals.

(Name of Credit Union)
(Address)

_____

(b) A federally-insured credit union that is merging with an uninsured credit union shall use the following language for purposes of terminating Federal insurance:

(1) *Notice of Proposal to Merge and Terminate Federal Insurance*

The Board of Directors of merging Credit Union has approved a proposition to merge the Credit Union into the (continuing) Credit Union. The merger must be approved by a majority of the members of (merging) Credit Union. The membership vote will be taken

on _____(date)_____. (Add directions regarding membership meeting and/or mail ballot.)

If the membership approves the merger, the share (deposit) insurance you now have (up to $100,000 provided by the National Credit Union Administration, (NCUA), an agency of the Federal Government) will be affected as follows:

Any deposits made by you after the effective date of the merger, either new deposits or additions to existing accounts, will not be insured by the NCUA. Accounts in the ___merging___ Credit Union on the date of the merger, up to a maximum of $100,000 for each member, will continue to be insured, as provided in the Federal Credit Union Act, for one (1) year after the close of business on the date of the merger, but any withdrawals after the close of business on that date will reduce the insurance coverage by the amount of the withdrawal.

(2) The language for the ballot set forth in (a)(2) above, modified by substituting "the merger and termination" in lieu of "termination" each time it appears on the ballot, shall be used for obtaining membership approval to merge and terminate Federal insurance.

(3) *Notice of Merger and Termination of Federal Insurance*

1. The merger of the ___(merging)___ Credit Union into the ___(continuing)___ Credit Union has been approved, effective ___(date)___.
2. The status of the ___(merging)___ Credit Union as an insured credit union under the provisions of the Federal Credit Union Act will terminate as of the close of business on the ___day of _____ (day preceding merger date).
3. Any deposits made by you after that date, either new deposits or additions to existing accounts, will not be insured by the National Credit Union Administration.
4. Accounts in the Credit Union on the ___day of _____, (day preceding merger date), up to a maximum of $100,000 for each member, will continue to be insured, as provided by the Federal Credit Union Act, for one (1) year after close of business on the _____day of _____, (day preceding merger date); Provided, however, that any withdrawals after the close of business on the ___day of _____, _____(day preceding merger date), will reduce the insurance coverage by the amount of such withdrawals.

(Name of Credit Union)
(Address)

(c) A Federal credit union that is converting its charter to that of an uninsured state credit union shall use the language contained in subsection (a) of this Section, but shall modify the language in (a)(1) to indicate that it is converting its charter and terminating Federal insurance.

§ 708b.302 Conversion of insurance.

(a) A federally-insured state credit union shall use the following language for purposes of converting from Federal insurance to nonfederal insurance:

(1) *Notice of Proposal to Convert to Non-federally-Insured Status*

The Board of Directors of _____ Credit Union has approved a proposition to convert from Federal share (deposit) insurance to nonfederal insurance. The conversion must be approved by a majority of the members who vote on the proposal and at least 20% of the entire membership must participate in the vote. The membership vote will be taken on ___(date)___. (Add directions regarding membership meeting and/or mail ballot.)

If the membership approves the conversion, the share (deposit) insurance you now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate on the effective date of the conversion. Shares (deposit) in the _____ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of _____.

(2) The ballot to obtain membership

approval of the conversion shall contain the following language:

This ballot must be received by the Credit Union by _____(date for vote)_____.

I understand that, if the conversion of insurance is approved, the share (deposit) insurance that I now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate upon the effective date of the conversion and my shares will be insured up to $_____ by _____, a corporation chartered by the State of _____.

[ ] Approve conversion of insurance.

[ ] Do not approve conversion of insurance.

Signed _____
Member's Name
Date _____

(3) *Notice of Conversion*

_____(Date)

1. The status of the _____as an insured credit union under the provisions of the Federal Credit Union Act will cease as of the close of business on the ____day of _____, _____.
2. As of that date, your deposits will no longer be insured by the National Credit Union Share Insurance Fund.
3. Accounts in the credit union will be insured up to $_____ by _____, a corporation chartered by the State of _____.

(Name of Credit Union)
(Address)

(b) A federally-insured credit union that is merging with a nonfederally-insured credit union shall use the following language for purposes of converting from Federal to nonfederal insurance:

(1) *Notice of Proposal to Merge and Convert to Nonfederally-Insured Status*

"The Board of Directors of __(merging)__ Credit Union has approved a proposition to merge the Credit Union into the __(continuing)__ Credit Union. The merger must be approved by a majority of the members of __(merging)__ Credit Union who vote on the proposal and at least 20% of the entire membership must participate in the vote. The membership vote will be taken on __(date)__. (Add directions regarding membership meeting and/or mail ballot.)

If the membership approves the merger, the share (deposit) insurance you now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate on the effective date of the merger. Shares (deposit) in the __(continuing)__ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of _____.

(2) The ballot to obtain membership approval shall contain the following language:

This ballot must be received by the Credit Union by _____(date for vote)_____.

I understand that if the merger of the __(merging)__ Credit Union into the __(continuing)__ Credit Union is approved, the share (deposit) insurance that I now have (up to $100,000 provided by the National Credit Union Administration, an agency of the Federal Government) will terminate upon the effective date of the merger and my shares in the ___(continuing)___ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of _____.

[ ] Approve merger and conversion of insurance.

[ ] Do not approve merger and conversion of insurance.

Signed _____
Member's Name
Date _____

(3) *Notice of Merger and Conversion of Insured Status*

_____(Date)

1. The merger of the ____(merging)____ Credit Union into the ___(continuing)___ Credit Union has been approved, effective ____(date)____.
2. As of that date, your shares (deposit) are no longer insured by the National Credit Union Administration.
3. Accounts in the ___(continuing)___ Credit Union will be insured up to $_____ by _____, a corporation chartered by the State of _____.

Name of Credit Union
(Address)

(c) A Federal credit union that is converting its charter to that of a nonfederally-insured credit union shall use the language contained in sub section (a) of this Section, but shall modify the language in (a) (1) to indicate that it is converting its charter and converting from Federal insurance.

§ 708b.303 Modifications to notice.

(a) Any modifications or additions to the notices or ballot concerning insurance coverage, and any additional communications concerning insurance coverage included with the notices or ballot, may be made with the approval of the Regional Director and, in the case of a state credit union, the appropriate state authority. Approval of such modifications, additions or additional communications will not be withheld unless it is determined that the credit union, by inclusion or omission of information, would materially mislead or misinform its membership.

(b) Federally-insured state credit unions may include additional language in the notice and ballot regarding state requirements for mergers, where appropriate.

Part 709

Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally Insured Credit Unions in Liquidation

§ 709.0 Scope.

The rules and procedures set forth in this Part apply to charter revocations of Federal credit unions pursuant to 12 U.S.C. § 1787(a)(1) (A), (B) and the involuntary liquidation and adjudication of creditor claims in all cases involving federally insured credit unions. Section 709.3 applies only to Federal credit unions. Remaining sections of this Regulation are applicable to all federally insured credit unions. This Part does not apply to share insurance claims arising out of the liquidation of a federally insured credit union. Insurance claims are decided pursuant to Part 745 of this Chapter.

§ 709.1 Definitions.

For the purposes of this Part, the following definitions apply:

(a) "General Counsel" means the General Counsel of the National Credit Union Administration or any attorney assigned to the General Counsel's staff.

(b) "Liquidating Agent" means the NCUA Board or person(s) appointed by it with delegated authority to carry out the liquidation of the credit union.

(c) "Insolvent" means insolvency as that term is defined in § 700.1(j) of these Regulations.

(d) "Claim" means a creditor's claim against the credit union in liquidation. This term does not include insurance claims arising out of the liquidation of a federally insured credit union. Insurance claims are decided pursuant to Part 745 of this Chapter.

(e) "Shareholder" means members, non-members, accountholders, or any other party or entity that is the owner of a share, share certificate or share draft account or the equivalent of such accounts under state law.

§ 709.2 NCUA Board as Liquidating Agent.

(a) The Board, as liquidating agent, by operation of law and without any conveyance or other instrument, act or deed, shall succeed to all the rights, titles, powers, and privileges of the credit union, and of its shareholders, officers, and directors, with respect to the credit union and its assets, and such shareholders, officers, or directors shall not thereafter have or exercise any such rights, powers, or privileges or act in connection with any assets or property of any nature of the credit union.

(b) The Board, as liquidating agent, shall take possession of and title to books, records, and assets of every description of such credit union to which such credit union has rights of possession and title to all offices and other facilities of such credit union.

§ 709.3 Challenge to Revocation of Charter and Involuntary Liquidation.

If a Federal credit union is determined to be insolvent and placed into liquidation pursuant to 12 U.S.C. § 1787, the Federal credit union may, not later than 10 days after the date on which the Board closes the credit union for liquidation, apply to the United States District Court for the judicial district in which the principal office of the credit union is located or the United States District Court for the District of Columbia for an order requiring the Board to show cause why it should not be prohibited from continuing such liquidation. Notwithstanding other provisions of this Part, the board of directors of the credit union may meet following the placing of the institution into liquidation for the sole purpose of considering and authorizing the filing of this action in the name of the credit union. No such action in the name of the credit union may be instituted without the authorization of the board of directors of the institution pursuant to a valid board of directors resolution. No credit union funds shall be available to pay expenses incurred in bringing a legal action to challenge the Board's liquidation action.

§ 709.4 Powers and Duties of Liquidating Agent.

(a) *Inventory of assets*—As soon as practicable after taking possession, the liquidating agent shall

inventory the assets of such credit union as of the date of taking possession, showing the value as carried on the books of the credit union, and the security therefor, if any, a brief description of the assets and any security, and a record of the credit union's creditor and accounts liabilities.

(b) *Notice to creditors*—The liquidating agent shall promptly publish a notice to the credit union's creditors to present their claims, together with proof, to the liquidating agent by a date specified in the notice. This date shall be not less than 90 days after the publication of the notice. The liquidating agent shall republish such notice approximately one and two months, respectively, after the initial publication. At the time of initial publication, the liquidating agent shall mail a notice similar to the published notice to any creditor shown on the credit union's books at the last address appearing therein. If the liquidating agent discovers the name of a creditor whose name does not appear on the credit union's books, a notice similar to the published notice shall be mailed to such creditor within 30 days after the discovery of the name and address.

(c) *General*—The liquidating agent shall collect all obligations and money due such credit union and may, to the extent consistent with its appointment, do all things desirable or expedient in its discretion to wind up the affairs of the credit union including, but not limited to, the following:

(1) exercise all rights and powers of the credit union including, but not limited to, any rights and powers under any mortgage, deed of trust, chose in action, option, collateral note, contract, judgment or decree, or instrument of any nature;

(2) institute, prosecute, maintain, defend, intervene, and otherwise participate in any and all actions, suits, or other legal proceedings by and against the liquidating agent or the credit union or in which the liquidating agent, the credit union, or its creditors or shareholders, or any of them, shall have an interest, and in every way to represent the credit union, its shareholders and creditors, subject to the direction of General Counsel;

(3) employ on a salary or fee basis such persons as in the judgment of the liquidating agent are necessary or desirable to carry out its responsibilities and functions, including, but not limited to, appraisers and Certified Public Accountants, and pay the costs out of the assets of the liquidated credit union;

(4) employ or retain any attorney or attorneys designated by, or acceptable to, the General Counsel in connection with litigation or for legal advice and assistance, for the liquidation generally or in particular instances, and pay compensation and retainers of such attorney or attorneys, together with all expenses, including, but not limited to, the costs and expenses of any litigation, as approved by the General Counsel, out of the assets of the liquidated credit union;

(5) execute, acknowledge, and deliver any and all deeds, contracts, leases, assignments, bills of sale, releases, extensions, satisfactions, and other instruments necessary or proper for any purposes, including, but not limited to, the effectuation, termination, or transfer of real, personal or mixed property, or that shall be necessary or proper to liquidate the credit union, and any deed or other instrument executed pursuant to the authority hereby given shall be as valid and effective for all purposes as if the same had been executed as the act and deed of the credit union;

(6) with concurrence of General Counsel, disaffirm or repudiate any contract or lease to which the credit union is a party, the performance of which the liquidating agent, in his sole discretion, determines to be burdensome, and which disaffirmance or repudiation in the liquidating agent's sole discretion will promote the orderly administration of the credit union's affairs;

(7) deposit, withdraw, or transfer funds, and otherwise exercise complete control over all investment or depository accounts maintained by or for the credit union at financial depository or similar institutions;

(8) do such things, and have such rights, powers, privileges, immunities, and duties, whether or not otherwise granted in the rules and regulations of this Part 709, as shall be authorized, directed, conferred, or imposed from time to time by the Board, or as shall be conferred by the Federal Credit Union Act;

(9) exercise such other authority as is conferred by the Federal Credit Union Act; and

(10) where acting as liquidating agent for a state-chartered federally insured credit union, exercise all the rights, powers, and privileges granted by state law to such a liquidating agent.

(d) *Expenditure of funds of the liquidation*—The liquidating agent shall have power to:

(1) pay all costs and expenses of the liquidation as determined by the liquidating agent;

(2) pay off and discharge taxes and liens;

(3) pay out and expend such sums as are deemed necessary or advisable for or in connection with the preservation, maintenance, conservation, protection, remodeling, repair, rehabilitation, or improvement of any asset or property of any nature of the credit union or the liquidating agent;

(4) pay off and discharge any assessments, liens, claims, or charges of any kind against any asset or property of any nature on which the credit union or the liquidating agent has a lien by way of mortgage, deed of trust, pledge, or otherwise, or in which the credit union or liquidating agent has any interest;

(5) settle, compromise, or obtain the release of, for cash or other consideration, claims and demands against the credit union or the liquidating agent; and

(6) indemnify its employees and agents from the assets of the credit union against liabilities incurred in the good faith performance of their duties.

(e) *Assets, claims, and contracts*—The liquidating agent shall have power to:

(1) sell for cash or on terms, exchange, assign, or otherwise dispose of, in whole or in part, any or all of the assets and property of the credit union, real, personal and mixed, tangible and intangible, of any nature, including any mortgage, deed of trust, chose in action, bond, note, contract, judgment, or decree, share or certificate of share of stock or debt, owing to the credit union or the liquidating agent; and

(2) surrender, abandon, and release any chose in action, or other assets or property of any nature, whether the subject of pending litigation or not, and settle, compromise, modify, or release, for cash or other consideration, claims and demands in favor of the credit union or the liquidating agent.

§ 709.5 Payout Priorities in Involuntary Liquidation.

(a) Claimants whose claims are secured shall receive their security. To the extent their respective claims exceed the value of the security for those claims, as determined to the satisfaction of the liquidating agent, they shall each have an unsecured claim against the credit union having priority as provided in paragraph (b) of this section.

(b) Unsecured claims against the liquidation estate that are proved to the satisfaction of the liquidating agent shall have priority in the following order:

(1) administrative costs and expenses of liquidation;

(2) claims for wages and salaries, including vacation, severance, and sick leave pay;

(3) taxes legally due and owing to the United States or any state or subdivision thereof;

(4) debts due and owing the United States, including the National Credit Union Administration;

(5) general creditors, and secured creditors (to the extent that their respective claims exceed the value of the security for those claims);

(6) shareholders to the extent of their respective uninsured shares and the National Credit Union Share Insurance Fund to the extent of its payment of share insurance;

(7) in a case involving liquidation of a corporate credit union, membership capital share deposits * of corporate credit unions;

(8) in a case involving liquidation of a low-income designated credit union, any outstanding secondary capital accounts issued pursuant to the authority of §§ 701.34 or 741.204(c) of this chapter, and

(9) in a case involving liquidation of a corporate credit union, paid-in capital. **

(c) Priorities are to be based on the circumstances that exist on the date of liquidation.

(d) If the repudiation or disaffirmance of any contract or lease gives rise to a claim for damages, such claim shall be considered a general creditor claim under paragraph (b)(5) of this section and not a cost or expense of liquidation under paragraph (b)(1) of this section.

(e) All unsecured claims of any category or class or priority described in paragraphs (b)(1) through (b)(7) of this section shall be paid in full, or provisions made for such payment, before any claims of lesser priority are paid. If there are insufficient funds to pay all claims of a category or class, payment shall be made pro rata. Notwithstanding anything to the contrary herein, the liquidating agent may, at any time, and from time to time, prior to the payment in full of all claims of a category or class with higher priority, make such distributions to claimants in priority categories described in paragraphs (b)(1), (b)(2), (b)(3), (b)(4),

* The term "membership capital share deposits" will be replaced by the term "membership capital" on Jan. 1, 1998.

** Paragraph 709.5(b)(9) becomes effective on Jan. 1, 1998.

and (b)(5) of this section as the liquidating agent believes are reasonably necessary to conduct the liquidation, provided that the liquidating agent determines that adequate funds exist or will be recovered during the liquidation to pay in full all claims of any higher priority. If a surplus remains after making distribution in full on all allowed claims described in paragraphs (b)(1) through (b)(8) of this section, such surplus shall be distributed pro rata to the credit union's shareholders.

§ 709.6 Initial Determination of Creditor Claims by the Liquidating Agent.

(a)(1) Any party wishing to submit a claim against the liquidated credit union must submit a written proof of claim in accordance with the requirements set forth in the notice to creditors. A failure to submit a written claim within the time provided in the notice to creditors shall be deemed a waiver of said claim and claimant shall have no further rights or remedies with respect to such claim.

(2) Notwithstanding paragraph (a)(1) of this section, the liquidating agent may, at his discretion, consider an untimely claim provided the following two criteria are present: (i) the claimant did not receive notice of the appointment of the liquidating agent in time to file a claim before the date provided for in the notice; and (ii) the claim is filed in time to permit payment of the claim.

(b) The liquidating agent may require submission of supplemental evidence by the claimant and by interested parties in the event of a dispute concerning a claim against any asset of the liquidated credit union. In requiring the submission of supplemental evidence, the liquidating agent may set such limitations of time, scope, and size as the liquidating agent deems reasonable in the circumstances, and may refuse to include in the record submissions or portions of submissions not in compliance with such limitations or requirements. The liquidating agent shall compile such written record of a claim or dispute as, in its discretion, is deemed sufficient to provide a reasonable basis for allowing or disallowing a claim or resolving a dispute. This written record shall be considered the administrative record.

(c) The liquidating agent shall determine whether to allow or disallow a claim and shall notify the claimant within 180 days from the date a claim against a credit union is filed pursuant to paragraph (a)(1) of this section. This 180-day period may be extended by written agreement between the claimant and the liquidating agent. Failure by the liquidating agent to determine a claim and notify the claimant within the 180-day period or, if the period is extended, within the extended period, shall be deemed a denial of the claim.

(d) If a claim or any portion thereof is disallowed, the notice to the claimant shall contain a statement of the reasons for the disallowance and an explanation of appeal rights pursuant to Section 709.7 of this Part.

(e) Notice of any determination with respect to a claim shall be sufficient if mailed to the most recent address of the claimant which appears:

(1) on the credit union's books;

(2) in the claim filed by the claimant; or

(3) in the documents submitted in the proof of claim.

(f) In the event the liquidating agent disallows all or part of a claim, the liquidating agent shall file with the Board, or its designated agent, a report of its determination. This report shall become part of the record and shall include the notice to the claimant and findings on all issues raised and decided by the liquidating agent.

§ 709.7 Procedures for Appeal of Initial Determination.

In order to appeal all or part of an initial decision which disallows a claim, in whole or in part, a claimant must, within 60 days of the mailing of the initial determination, file an administrative appeal pursuant to Section 709.8 of this Part, or file suit against the liquidated credit union in the United States District Court for the District of Columbia or in the United States District Court having jurisdiction over the place where the credit union's principal place of business is located, or continue an action commenced before the appointment of the liquidating agent. If the claimant does not appeal or file or continue a suit, any disallowance shall be final and the claimant shall have no further rights or remedies with respect to such claim.

§ 709.8 Administrative Appeal of the Initial Determination.

(a) *General*—A claimant requesting an administrative appeal may request review pursuant to any of the procedures listed in paragraphs (b) or (c) of this section. Any appeal of the initial determination must be in writing and must specify what type of appeal the claimant requests. The determination of whether to agree to a request

for administrative appeal shall rest solely with the Board, which shall notify the claimant of its decision in writing. The 60-day period for filing a lawsuit in United States District Court, provided for in Section 709.7 of this Part, shall be tolled from the date of claimant's request for an administrative appeal to the date of the Board's decision regarding that request.

(b) *Hearing on the record*—Except as provided herein, any hearing requested pursuant to this section shall be conducted in accordance with the provisions of Subpart A, Part 747, of this Chapter. The Board shall render a final decision with respect to such claim after consideration of the hearing record and recommended decision. The Board's determination shall be subject to judicial review under Chapter 7 of Title 5, United States Code. Any claimant seeking judicial review of the Board's final decision under this paragraph must file a petition in the court of appeals for the circuit in which the principal office of the credit union is located, or in the United States Court of Appeals for the District of Columbia Circuit, within 30 days of the date of the Board's final decision. If a claimant does not file a petition before the end of the 30-day period, the Board's decision shall be final, and the claimant shall have no further rights or remedies with respect to such claim.

(1) *Burden of proof*—In any hearing on the record, the burden of proof to establish entitlement to any modification of the initial determination shall rest solely upon the claimant.

(2) *Order of procedure*—In any hearing on the record, at the time for opening arguments, counsel for the claimant shall argue first, and at the time for closing arguments, counsel for the claimant shall argue last.

(c) *Alternative dispute resolution*—Paragraphs (c) (1) and (2) of this section list alternatives for dispute resolution which may be available at the discretion of the Board. From time to time, the NCUA Board may authorize additional alternative dispute resolution processes.

(1) *Appeal to the Board*—Pursuant to this paragraph (c)(1), the claimant may file an appeal with the NCUA Board within the time provided for in Section 709.7. The appeal must be in writing and filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. There shall be no personal appearance before the Board in connection with an appeal under this paragraph (c)(1).

(i) *Content of appeal*—Any appeal must include:

(A) a statement of the facts on which the appeal is based;

(B) a statement of the basis for the initial determination to which the claimant objects and the alleged error in such determination, including citations to applicable statutes and regulations;

(C) any other evidence relied upon by the claimant which was not previously provided to the liquidating agent.

(ii) *Procedures for review of the appeal*—

(A) Within 60 days of the date of the Board's receipt of an appeal, pursuant to paragraph (c)(1) of this section, the Board may request in writing that the claimant submit supplemental evidence in support of its appeal. If additional evidence is requested, the claimant shall have 45 days from the date of issuance of such request to provide such additional information. Failure by the claimant to provide such additional information may, as determined solely by the Board, result in denial of the claimant's appeal.

(B) Within 60 days from the date of the Board's receipt of an appeal, pursuant to paragraph (c)(1) of this section, the claimant may amend or supplement the appeal in writing. In the event the claimant does amend or supplement the appeal, the provisions of paragraph (c)(1)(ii)(A) of this section, with respect to requests for additional information and responses to such requests, shall apply with equal force to any such amendment or supplement to an appeal.

(iii) *Determination on appeal*—

(A) Within 180 days from the date of receipt of an appeal by the Board, the Board shall issue a decision allowing or disallowing claimant's appeal.

(B) The decision by the Board on appeal shall be provided to the claimant in writing, stating the reasons for the decision, and shall constitute a final agency decision regarding the claimant's claim.

(C) Failure by the Board to issue a decision on appeal of the claimant's claim within the 180-day period provided for under paragraph (c)(1)(iii)(A) shall be deemed to be denial of such appeal for the purposes of paragraph (c)(1)(iv) of this section.

(iv) *Judicial review*—

(A) For the purposes of seeking judicial review of actions taken pursuant to paragraph (c)(1) of this section, only a determination on appeal issued by the NCUA Board pursuant to

this section shall constitute a final determination regarding a claim.

(B) A final determination by the Board is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States Court of Appeals for the District of Columbia or the court of appeals for the Federal judicial circuit where the credit union's principal place of business is located. Any request for judicial review under this subparagraph must be filed within 60 days of the date of the Board's final decision. If any claimant fails to file before the end of the 60-day period, the Board's decision shall be final, and the claimant shall have no further rights or remedies with respect to such claim.

(2) The following additional procedures for dispute resolution may be made available at the sole discretion of the Board: mediation; nonbinding arbitration; and neutral fact finding.

§ 709.9 Expedited Determination of Creditor Claims.

(a) *General*—The provisions of this section establish procedures under which claimants may request expedited relief in lieu of the procedures set forth in Section 709.6 of this Part. A claimant shall be entitled to expedited determination of a claim only upon a showing that there exists a legally valid and enforceable or perfected security interest in assets of the liquidated credit union and that irreparable injury will occur if the routine claims procedure is followed.

(b) *Filing of request for expedited relief*—All requests for expedited relief must be filed within 30 days from the date of mailing, by the liquidating agent, of the notice to the creditor concerned. The request shall be deemed to be filed when received by the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. A copy of the request must be simultaneously served upon the liquidating agent for the credit union concerned. There shall be no right of personal appearance before the Board in connection with any claim submitted under this paragraph.

(c) *Content of request for expedited relief*—Any Request for Expedited Relief must contain the following:

(1) a clear and concise statement of the facts and issues on which the request is based;

(2) a clear and concise statement describing the nature of any security interests in any assets of the credit union;

(3) a clear and concise statement of the probable, imminent and irreparable harm likely to occur if expedited relief is not granted;

(4) an assessment of the likelihood of success on the merits of the underlying claim, including statutory citations and relevant documentation supporting the merits of the claim;

(5) any other relevant documentation that supports the request;

(6) citations to applicable statutes, regulations, or other legal authority; and

(7) a signed statement certifying that a copy of the request has been mailed or hand delivered to the liquidating agent on or before the day that the request was filed with the Board.

(d) *Burden of proof*—The burden of proving entitlement to expedited relief rests at all times with the requester.

(e) *Additional information*—The Board may order the filing of additional information and/or documentation in order to make its determination. Such filing shall be on a date certain, and failure to provide the additional documentation or information may constitute the sole grounds for denial of the request.

(f) *Decision*—Before the end of the 90-day period beginning on the date a request is filed, the Board shall render its decision and provide it to the requester. The Board will determine whether to grant expedited review and allow or disallow the claim or whether such claim should be resolved pursuant to the claims process described in Section 709.6 of this Part.

(1) *Expedited review denied*—A decision by the Board that expedited review is not appropriate shall be final and the claim shall be decided pursuant to the claims adjudication process set forth in Section 709.6 of this Part.

(2) *Expedited review granted*—If expedited review is granted, the Board shall decide the claim. If the claim is disallowed, in whole or part, the decision shall contain a statement of each reason for the disallowance and the procedure for obtaining judicial review.

(g) *Period for filing or renewing suit*—Any claimant who files a request for expedited relief shall be permitted to file a suit, or to continue a suit filed before the appointment of the liquidating agent, seeking a determination of the claimant's rights with respect to its security interest after the earlier of:

(1) the end of the 90-day period beginning on the date of the filing of a request for expedited relief; or

(2) the date the Board denies all or part of the claim.

Part 710

Voluntary Liquidation

§ 710.0 Scope.

This Part prescribes the requirements that must be followed to accomplish the voluntary liquidation of a Federal credit union. Federally insured state credit unions are only subject to the notification requirement provided in § 710.9; voluntary liquidation is to be accomplished in accordance with state law or procedures established by the state regulatory authority.

§ 710.1 Definitions.

For the purpose of this Part, the following definitions apply:

(a) *Voluntary liquidation* means the dissolution of a solvent Federal credit union with the assets being sold or collected, liabilities paid, and shares distributed under the direction of the board of directors or its duly appointed liquidating agent.

(b) *Liquidation date* means the date the members vote to approve liquidation.

(c) *Liquidating agent* means the person or persons, including any legally recognized entity, appointed by the board of directors to liquidate the Federal credit union.

§ 710.2 Responsibility for Conducting Voluntary Liquidation.

(a) The board of directors shall be responsible for conserving the assets, for expediting the liquidation, and for equitable distribution of the assets to the members.

(b) After voting to present the question of liquidation to the members, the board of directors may appoint a liquidating agent and delegate all or part of the board's responsibility to such agent and authorize reasonable compensation for the services provided.

(c) The board of directors shall determine that the liquidating agent and all persons who handle or have access to funds of the Federal credit union are adequately covered by surety bond and that either such coverage remains in effect, or the discovery period is extended, for at least four months after final distribution of assets.

(d) Within three days after the decision of the board of directors to submit the question of liquidation to the members, the Regional Director will be notified in writing, setting forth in detail the reasons for the proposed action. A balance sheet and income statement as of the previous month-end will be included with the notification. During the liquidation process, financial statements will be submitted to the Regional Director as requested.

(e) Promptly after the decision to present the question of liquidation to the members, the board of directors or liquidating agent shall develop a written plan for the liquidation of the assets and payment of shares (liquidation plan). The plan should provide for the liquidation of assets and payment of creditors and shareholders within one year of the liquidation date. If the liquidation period is projected to exceed one year, an explanation must be provided in the liquidation plan. A copy of the liquidation plan will be mailed to the Regional Director within 30 days of the date the board of directors votes to present the question of liquidation to the members.

§ 710.3 Approval of the Liquidation Proposal by Members.

(a) When the board of directors decides to present the question of liquidation to the members, it shall act promptly to obtain the members' approval. The members shall be given advance notice of the membership meeting at which the liquidation proposal is to be submitted, in accordance with the provisions of Article V of the Federal Credit Union Bylaws. The notice shall:

(1) Inform members that they have the right to vote on the liquidation proposal in person at the membership meeting called for that purpose or by written ballot to be received no later than the time and date indicated on the notice.

(2) Include or be accompanied by a ballot for the liquidation proposal.

(b) The liquidation proposal must be approved by the affirmative vote of a majority of the Federal credit union members who vote on the proposal.

(c) If the members do not approve the liquidation, the board of directors, or if delegated the authority, the liquidating agent, must decide within seven days whether the Federal credit union should resume operations or, if good cause exists, to resubmit the question of liquidation to the members.

(d) If the members approve the liquidation, neither the members nor the board of directors may rescind the decision to liquidate unless the Regional Director concurs in the rescission.

(e) The Regional Director will be notified in writing of the results of the membership vote on the voluntary liquidation proposal within three days of the date of the vote.

§ 710.4 Transaction of Business During Liquidation.

(a) Immediately upon decision by the board of directors to present the question of liquidation to the members, payments on shares, withdrawal of shares (except for transfer of shares to loans and interest), transfer of shares to another share account, granting of loans, and making of investments other than short-term investments shall be suspended pending action by the members on the proposal to liquidate. Collection of loans and interest, payment of necessary expenses, clearing of share drafts and credit card charges will continue.

(b) Upon approval of the members, payments on shares, withdrawal of shares (except for transfer of shares to loans and interest), transfer of shares to another share account, granting of loans, and making of investments other than short-term investments shall be discontinued permanently. Collection of loans and interest and payment of necessary expenses will continue during the period of liquidation. Members will be notified to discontinue the use of share drafts and credit cards, and items will not be cleared 15 days from the liquidation date.

(c) Approval of the Regional Director must be obtained prior to consummating any sale of assets which would not provide sufficient funds to pay shareholders at par.

§ 710.5 Notice of Liquidation to Creditors.

(a) When approval for liquidation is obtained from the members, the board of directors or the liquidating agent shall cause notice to be given to creditors to present their claims.

(1) Federal credit unions with assets in excess of $5 million as of the month-end prior to the liquidation date shall publish the notice once a week in each of three successive weeks, in a newspaper of general circulation, in each county in which the Federal credit union maintains an office or branch for the transaction of business on the liquidation date. The first notice shall be published within seven days of the liquidation date.

(2) Federal credit unions with assets in excess of $500,000 but less than $5 million as of the month-end prior to the liquidation date shall publish the notice once, in a newspaper of general circulation, in each county in which the Federal credit union maintains an office or branch for the transaction of business on the liquidation date. The notice shall be published within seven days of the liquidation date.

(3) Federal credit unions with assets less than $500,000 as of the month-end prior to the liquidation date shall not be required to publish the notice.

(b) Within 10 days of the liquidation date, a copy of the notice of liquidation shall be mailed to all creditors reflected on the records of the Federal credit union.

(c) Creditors shall be provided 30 days from the liquidation date to submit their claims.

§ 710.6 Distribution of Assets.

(a) With the approval of the Regional Director, a partial pro rata distribution of the Federal credit union's assets may be made to its members from cash funds available on authorization by the board of directors or liquidating agent. Payment of a partial distribution may exclude member accounts of less than $25.00.

(b) After all assets of the Federal credit union have been converted to cash or found to be worthless and all loans and debts owing to it have been collected or found to be uncollectible and all obligations of the Federal credit union have been paid, with the exception of shares due its members, the books shall be closed and the pro rata distribution to the members shall be computed. The computation shall be based on the total amount in each share account.

(c) Promptly after the pro rata distribution to members has been computed, checks shall be drawn for the amounts to be distributed to each

member. The checks shall be mailed to the members at their last known address or handed to them in person.

(d) Unclaimed share accounts, unpaid claims, and unpaid claims of members or creditors who failed to cash their final distribution checks shall be trusteed or escheated in accordance with the laws of the state in which the member or creditor resides.

(e) The Regional Director will be notified in writing within three days when the final distribution of assets to the members is started.

§ 710.7 Retention of Records.

(a) The board of directors or liquidating agent shall appoint a custodian for the Federal credit union's records which are to be retained after the final distribution of assets.

(b) All records of the liquidated Federal credit union necessary to establish that creditors were paid and that assets were equitably distributed to the members shall be retained by the custodian for a period of five years following the date of charter cancellation.

§ 710.8 Certificate of Dissolution and Liquidation.

Within 120 days after the final distribution of assets to members is started, a duly executed Certificate of Dissolution and Liquidation shall be filed with the Regional Director.

§ 710.9 Federally Insured State Credit Unions.

A federally insured state credit union will notify the Regional Director in writing within three days after the board of directors' decision to liquidate is made. A balance sheet and income statement as of the previous month-end and a copy of any liquidation plan will be included with the notification to the Regional Director.

Part 711

Management Official Interlocks

§ 711.1 Authority, Purpose and Scope.

(a) *Authority.* This part is issued under the provisions of the Depository Institution Management Interlocks Act (Interlocks Act) (12 U.S.C. 3201 *et seq*).

(b) *Purpose.* The purpose of the Interlocks Act and this part is to foster competition by generally prohibiting a management official from serving two nonaffiliated depository organizations in situations where the management interlock likely would have an anticompetitive effect.

(c) *Scope.* This part applies to management officials of federally insured credit unions. Section 711.4(c) exempts a management official of a credit union from the prohibitions of the Interlocks Act when the individual serves as a management official of another credit union. Therefore, the Interlocks Act prohibitions contained in this part only apply to a management official of a credit union when that individual also serves as a management official of another type of depository organization (usually a bank or thrift).

§ 711.2 Definitions.

For purposes of this part, the following definitions apply:

(a) *Affiliate.* (1) The term *affiliate* has the meaning given in section 202 of the Interlocks Act (12 U.S.C. 3201). For purposes of that section 202, shares held by an individual include shares held by members of his or her immediate family. "Immediate family" means spouse, mother, father, child, grandchild, sister, brother, or any of their spouses, whether or not any of their shares are held in trust.

(2) For purposes of section 202(3)(B) of the Interlocks Act (12 U.S.C. 3201(3)(B)), an affiliate relationship involving a depository institution based on common ownership does not exist if the appropriate federal supervisory agency determines, after giving the affected persons the opportunity to respond, that the asserted affiliation was established in order to avoid the prohibitions of the Interlocks Act and does not represent a true commonality of interest between the depository organizations. In making this determination, the appropriate Federal supervisory agency considers, among other things, whether a person, including members of his or her immediate family, whose shares are necessary to constitute the group owns a nominal percentage of the shares of one of the organizations and the percentage is substantially disproportionate to that person's ownership of shares in the other organization.

(b) *Anticompetitive effect* means a monopoly or substantial lessening of competition.

(c) *Area median income* means:

(1) The median family income for the metropolitan statistical area (MSA), if a depository organization is located in an MSA; or

(2) The statewide nonmetropolitan median family income, if a depository organization is located outside an MSA.

(d) *Community* means a city, town, or village, and contiguous or adjacent cities, towns, or villages.

(e) *Contiguous or adjacent cities, towns, or villages* means cities, towns, or villages whose borders touch each other or whose borders are within 10 road miles of each other at their closest points. The property line of an office located in an unincorporated city, town, or village is the boundary line of that city, town, or village for the purpose of this definition.

(f) *Critical* means important to restoring or maintaining a depository organization's safe and sound operations.

(g) *Depository holding company* means a bank holding company or a savings and loan holding company (as more fully defined in section 202 of the Interlocks Act (12 U.S.C. 3201) having its principal office located in the United States.

(h) *Depository institution* means a commercial bank (including a private bank), a savings bank, a trust company, a savings and loan association, a building and loan association, a homestead association, a cooperative bank, an industrial bank, or a credit union, chartered under the laws of the United States and having a principal office located in the United States. Additionally, a United States

office, including a branch or agency, of a foreign commercial bank is a depository institution.

(i) *Depository institution affiliate* means a depository institution that is an affiliate of a depository organization.

(j) *Depository organization* means a depository institution or a depository holding company.

(k) *District bank* means any State bank operating under the Code of Law of the District of Columbia.

(l) *Low- and moderate-income areas* means census tracts (or, if an area is not in a census tract, block numbering areas delineated by the United States Bureau of the Census) where the median family income is less than 100 percent of the area median income.

(m) *Management official.* (1) The term *management official* means:

(i) A director;

(ii) An advisory or honorary director of a depository institution with total assets of $100 million or more;

(iii) A senior executive officer as that term is defined in 12 CFR 701.14(b)(2), or a person holding an equivalent position regardless of title;

(iv) A branch manager;

(v) A trustee of a depository organization under the control of trustees; and

(vi) Any person who has a representative or nominee serving in any of the capacities in this paragraph (m)(1).

(2) The term *management official* does not include:

(i) A person whose management functions relate exclusively to the business of retail merchandising or manufacturing;

(ii) A person whose management functions relate principally to the business outside the United States of a foreign commercial bank; or

(iii) A person described in the provisions of section 202(4) of the Interlocks Act (12 U.S.C. 3201(4)) (referring to an officer of a State-chartered savings bank, cooperative bank, or trust company that neither makes real estate mortgage loans nor accepts savings).

(n) *Office* means a principal or branch office of a depository institution located in the United States. *Office* does not include a representative office of a foreign commercial bank, an electronic terminal, or a loan production office.

(o) *Person* means a natural person, corporation, or other business entity.

(p) *Relevant metropolitan statistical area (RMSA)* means an MSA, a primary MSA, or a consolidated MSA that is not comprised of designated primary MSAs to the extent that these terms are defined and applied by the Office of Management and Budget.

(q) *Representative or nominee* means a natural person who serves as a management official and has an obligation to act on behalf of another person with respect to management responsibilities. NCUA will find that a person has an obligation to act on behalf of another person only if the first person has an agreement, express or implied, to act on behalf of the second person with respect to management responsibilities. NCUA will determine, after giving the affected persons an opportunity to respond, whether a person is a *representative or nominee.*

(r) *Total assets.* (1) The term *total assets* means assets measured on a consolidated basis and reported in the most recent fiscal year-end Consolidated Report of Condition and Income.

(2) The term *total assets* does not include:

(i) Assets of a diversified savings and loan holding company as defined by section 10(a)(1)(F) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(F)) other than the assets of its depository institution affiliate;

(ii) Assets of a bank holding company that is exempt from the prohibitions of section 4 of the Bank Holding Company Act of 1956 pursuant to an order issued under section 4(d) of that Act (12 U.S.C. 1843(d)) other than the assets of its depository institution affiliate; or

(iii) Assets of offices of a foreign commercial bank other than the assets of its United States branch or agency.

(s) *United States* includes any State or territory of the United States of America, the District of Columbia, Puerto Rico, Guam, American Samoa, and the Virgin Islands.

§ 711.3 Prohibitions.

(a) *Community.* A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations in question (or a depository institution affiliate thereof) have offices in the same community.

(b) *RMSA.* A management official of a depository organization may not serve at the same time as a management official of an unaffiliated depository organization if the depository organizations

in question (or a depository institution affiliate thereof) have offices in the same RMSA and each depository organization has total assets of $20 million or more.

(c) *Major assets.* A management official of a depository organization with total assets exceeding $1 billion (or any affiliate thereof) may not serve at the same time as a management official of an unaffiliated depository organization with total assets exceeding $500 million (or any affiliate thereof), regardless of the location of the two depository organizations.

§ 711.4 Interlocking relationships permitted by statute.

The prohibitions of § 711.3 do not apply in the case of any one or more of the following organizations or to a subsidiary thereof:

(a) A depository organization that has been placed formally in liquidation, or which is in the hands of a receiver, conservator, or other official exercising a similar function;

(b) A corporation operating under section 25 or section 25A of the Federal Reserve Act (12 U.S.C. 601 *et seq.* and 12 U.S.C. 611 *et seq.*, respectively) (Edge Corporations and Agreement Corporations);

(c) A credit union being served by a management official of another credit union;

(d) A depository organization that does not do business within the United States except as an incident to its activities outside the United States;

(e) A State-chartered savings and loan guaranty corporation;

(f) A Federal Home Loan Bank or any other bank organized solely to serve depository institutions (a bankers' bank) or solely for the purpose of providing securities clearing services and services related thereto for depository institutions and securities companies;

(g) A depository organization that is closed or is in danger of closing as determined by the appropriate Federal depository institutions regulatory agency and is acquired by another depository organization. This exemption lasts for five years, beginning on the date the depository organization is acquired; and

(h)(1) A diversified savings and loan holding company (as defined in section 10(a)(1)(F) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(F)) with respect to the service of a director of such company who also is a director of an unaffiliated depository organization if:

(i) Both the diversified savings and loan holding company and the unaffiliated depository organization notify their appropriate Federal depository institutions regulatory agency at least 60 days before the dual service is proposed to begin; and

(ii) The appropriate regulatory agency does not disapprove the dual service before the end of the 60-day period.

(2) The NCUA Board or its designee may disapprove a notice of proposed service if it finds that:

(i) The service cannot be structured or limited so as to preclude an anticompetitive effect in financial services in any part of the United States;

(ii) The service would lead to substantial conflicts of interest or unsafe or unsound practices; or

(iii) The notificant failed to furnish all the information required by NCUA.

(3) The NCUA Board or its designee may require that any interlock permitted under this paragraph (h) be terminated if a change in circumstances occurs with respect to one of the interlocked depository organizations that would have provided a basis for disapproval of the interlock during the notice period.

§ 711.5 Regulatory Standards exemption.

(a) *Criteria.* NCUA may permit an interlock that otherwise would be prohibited by the Interlocks Act and § 711.3 if:

(1) The board of directors of the depository organization (or the organizers of a depository organization being formed) that seeks the exemption provides a resolution to NCUA certifying that the organization, after the exercise of reasonable efforts, is unable to locate any other candidate from the community or RMSA, as appropriate, who:

(i) Possesses the level of expertise required by the depository organization and who is not prohibited from service by the Interlocks Act; and

(ii) Is willing to serve as a management official; and

(2) NCUA, after reviewing an application submitted by the depository organization seeking the exemption, determines that:

(i) The management official is critical to the safe and sound operations of the affected depository organization; and

(ii) Service by the management official will not produce an anticompetitive effect with respect to the depository organization.

(b) *Presumptions.* NCUA applies the following presumptions when reviewing any application for a Regulatory Standards exemption. A proposed management official is critical to the safe and sound operations of a depository institution if:

(1) That official is approved by NCUA to serve as a director or senior executive officer of that institution pursuant to 12 CFR 701.14 or pursuant to conditions imposed on a newly chartered credit union; and

(2) The institution had operated for less than two years, was not in compliance with minimum capital requirements, or otherwise was in a "troubled condition" as defined in 12 CFR 701.14 at the time the service under 12 CFR 701.14 was approved.

(c) *Duration of interlock.* An interlock permitted under this section may continue until NCUA notifies the affected depository organizations otherwise. NCUA may require a credit union to terminate any interlock permitted under this section if NCUA concludes, after giving the affected persons the opportunity to respond, that the determinations under paragraph (a)(2) of this section no longer may be made. A management official may continue serving the depository organization involved in the interlock for a period of 15 months following the date of the order to terminate the interlock. NCUA may shorten this period under appropriate circumstances.

§ 711.6 Management Consignment exemption.

(a) *Criteria.* NCUA may permit an interlock that otherwise would be prohibited by the Interlocks Act and § 711.3 if NCUA, after reviewing an application submitted by the depository organization seeking an exemption, determines that the interlock would:

(1) Improve the provision of credit to low- and moderate-income areas;

(2) Increase the competitive position of a minority- or women-owned depository organization;

(3) Strengthen the management of a depository institution that has been chartered for less than two years at the time an application is filed under this part; or

(4) Strengthen the management of a depository institution that is in an unsafe or unsound condition as determined by NCUA on a case-by-case basis.

(b) *Presumptions.* NCUA applies the following presumptions when reviewing any application for a Management Consignment exemption:

(1) A proposed management official is capable of strengthening the management of a depository institution described in paragraph (a)(3) of this section if that official is approved by NCUA to serve as a director or senior executive officer of that institution pursuant to 12 CFR 701.14 or pursuant to conditions imposed on a newly chartered credit union and the institution had operated for less than two years at the time the service under 12 CFR 701.14 was approved; and

(2) A proposed management official is capable of strengthening the management of a depository institution described in paragraph (a)(4) of this section if that official is approved by NCUA to serve as a director or senior executive officer of that institution pursuant to 12 CFR 701.14 and the institution was in a "troubled condition" as defined under 12 CFR 701.14 at the time service under that section was approved.

(c) *Duration of interlock.* An interlock granted under this section may continue for a period of two years from the date of approval. NCUA may extend this period for one additional two-year period if the depository organization applies for an extension at least 30 days before the current exemption expires and satisfies one of the criteria specified in paragraph (a) of this section. The provisions set forth in paragraph (b) of this section also apply to applications for extensions.

§ 711.7 Change in circumstances.

(a) *Termination.* A management official shall terminate his or her service or apply for an exemption to the Interlocks Act if a change in circumstances causes the service to become prohibited under that Act. A change in circumstances may include, but is not limited to, an increase in asset size of an organization, a change in the delineation of the RMSA or community, the establishment of an office, an acquisition, a merger, a consolidation, or any reorganization of the ownership structure of a depository organization that

causes a previously permissible interlock to become prohibited.

(b) *Transition period.* A management official described in paragraph (a) of this section may continue to serve the depository organization involved in the interlock for 15 months following the date of the change in circumstances. NCUA may shorten this period under appropriate circumstances.

§ 711.8 Enforcement.

Except as provided in this section, NCUA administers and enforces the Interlocks Act with respect to federally insured credit unions, and may refer any case of a prohibited interlocking relationship involving these entities to the Attorney General of the United States to enforce compliance with the Interlocks Act and this part.

Part 721

Federal Credit Union Insurance and Group Purchasing Activities

§ 721.1 Authority.

A Federal credit union may make insurance and group purchasing plans involving outside vendors available to the membership (including endorsement), and may perform administrative functions on behalf of the vendors.

§ 721.2 Reimbursement.

(a) For purposes of paragraph (b) of this section, the following definitions shall apply:

(1) "Dollar amount" shall mean $4 per single payment policy, $6 per combination policy, or $4 per annum for any other type of policy; and

(2) "Cost amount" shall mean the total of the direct and indirect costs to the Federal credit union of any administrative functions performed on behalf of the vendor. The Federal credit union must be able to justify this amount using standard accounting procedures.

(b) A Federal credit union may be reimbursed or compensated by a vendor for activities performed under § 721.1 as follows:

(1) Except as otherwise provided by applicable state insurance law, reimbursement or compensation is not limited with respect to insurance sales by the credit union or its employees which are directly related to an extension of credit by the credit union or directly related to the opening or maintenance of a share, share draft or share certificate account at the credit union;

(2) For insurance sales other than those described in paragraph (b)(1), a Federal credit union may receive an amount not exceeding the greater of the dollar amount or the cost amount;

(3) For group purchasing plans other than insurance, a Federal credit union may receive an amount not exceeding the cost amount.

(c) No director, committee member, or senior management employee of a Federal credit union or any immediate family member of any such individual may receive any compensation or benefit, directly or indirectly, in conjunction with any activity under this Part. For purposes of this Section, "immediate family member" means a spouse or other family member living in the same household; and "senior management employee" means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(d) The prohibition contained in subsection (c) also applies to any employee not otherwise covered if the employee is directly involved in insurance or group purchasing activities unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(e) All transactions with business associates or family members not specifically prohibited by subsection (c) must be conducted at arm's length and in the interest of the credit union.

Part 722

Appraisals

§ 722.1 Authority, Purpose, and Scope.

(a) *Authority.* Part 722 is issued by the National Credit Union Administration ("NCUA") under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") (Pub. L. No. 101–73, 103 Stat. 183, 1989) and 12 U.S.C. 1757 and 1766.

(b) *Purpose and Scope.* (1) Title XI provides protection for federal financial and public policy interests in real estate-related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This Part implements the requirements of Title XI and applies to all federally related transactions entered into by the National Credit Union Administration or by federally insured credit unions ("regulated institutions").

(2) This Part:

(i) identifies which real estate-related financial transactions require the services of an appraiser;

(ii) prescribes which categories of federally related transactions shall he appraised by a state-certified appraiser and which by a state-licensed appraiser; and

(iii) prescribes minimum standards for the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the National Credit Union Administration.

§ 722.2 Definitions.

(a) "Appraisal" means a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately-described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

(b) "Appraisal Foundation" means the Appraisal Foundation established on November 30, 1987, as a not-for-profit corporation under the laws of Illinois.

(c) "Appraisal Subcommittee" means the Appraisal Subcommittee of the Federal Financial Institutions Examination Council.

(d) "Complex 1-to-4 family residential property appraisal" means one in which the property to be appraised, the form of ownership, or market conditions are atypical.

(e) "Federally related transaction" means any real estate-related financial transaction entered into on or after August 9, 1990, that:

(1) the National Credit Union Administration, or any federally insured credit union, engages in or contracts for; and

(2) requires the services of an appraiser.

(f) "Market value" means the most probable price which a property should bring in a competitive and open market under all conditionsrequisite to a fair sale, the buyer and seller each acting prudently and knowledgeably and as suming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(1) buyer and seller are typically motivated;

(2) both parties are well informed or well advised, and acting in what they consider their own best interests;

(3) a reasonable time is allowed for exposure in the open market;

(4) payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

(5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(g) "Real estate or real property" means an identified parcel or tract of land, including easements, rights of way, undivided or future interests and similar rights in a parcel or tract of land, but does not include mineral rights, timber rights, and growing crops, water rights and similar interests severable from the land when the transaction does not involve the associated parcel or tract of land.

(h) "Real estate-related financial transaction" means any transaction involving:

(1) the sale, lease, purchase, investment in or exchange of real property, including interests in property, or the financing thereof; or

(2) the refinancing of real property or interests in real property; or

(3) the use of real property or interests in property as security for a loan or investment, including mortgage-backed securities.

(i) "State-certified appraiser" means any individual who has satisfied the requirements for certification in a state or territory whose criteria for certification as a real estate appraiser currently meet the minimum criteria for certification issued by the Appraiser Qualification Board of the Appraisal Foundation. No individual shall be a state-certified appraiser unless such individual has achieved a passing grade upon a suitable examination administered by a state or territory that is consistent with and equivalent to the Uniform State Certification Examination issued or endorsed by the Appraiser Qualification Board. In addition, the Appraisal Subcommittee must not have issued a finding that the policies, practices, or procedures of a state or territory are inconsistent with Title XI of FIRREA. The National Credit Union Administration may, from time to time, impose additional qualification criteria for certified appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(j) "State-licensed appraiser" means any individual who has satisfied the requirements for licensing in a state or territory where the licensing procedures comply with Title XI of FIRREA and where the Appraisal Subcommittee has not issued a finding that the policies, practices, or procedures of the state or territory are inconsistent with Title XI. The NCUA may, from time to time, impose additional qualification criteria for licensed appraisers performing appraisals in connection with federally related transactions within its jurisdiction.

(k) "Tract development" means a project of five units or more that is constructed or is to be constructed as a single development.

(l) "Transaction value" means:

(1) for loans or other extensions of credit, the amount of the loan or extension of credit;

(2) for sales, leases, purchases, and investments in or exchanges of real property, the market value of the real property interest involved; and

(3) for the pooling of loans or interests in real property for resale or purchase, the amount of the loan or market value of the real property calculated with respect to each such loan or interest in real property.

§ 722.3 Appraisals required; transactions requiring a State certified or licensed appraiser.

(a) *Appraisals required.* An appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions except those in which:

(1) The transaction value is $100,000 or less except if it is a business loan and then the transaction value is $50,000 or less;

(2) A lien on real property has been taken as collateral through an abundance of caution and where the terms of the transaction as a consequence have not been made more favorable than they would have been in the absence of a lien;

(3) A lien on real estate has been taken for purposes other than the real estate's value;

(4) A lease of real estate is entered into, unless the lease is the economic equivalent of a purchase or sale of the leased real estate;

(5) The transaction involves an existing extension of credit at the credit union, provided that:

(i) There is no advancement of new monies, other than funds necessary to cover reasonable closing costs; and

(ii) There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the credit union's real estate collateral protection after the transaction;

(6) The transaction involves the purchase, sale, investment in, exchange of, or extension of credit secured by, a loan or interest in a loan, pooled loans, or interests in real property, including mortgage-backed securities, and each loan or interest in a loan, pooled loan, or real property interest met the requirements of this regulation, if applicable, at the time of origination;

(7) The transaction is wholly or partially insured or guaranteed by a United States government agency or United States government sponsored agency; or

(8) The transaction either:

(i) Qualifies for sale to a United States government agency or United States government sponsored agency; or

(ii) Involves a residential real estate transaction in which the appraisal conforms to the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation appraisal standards applicable to that category of real estate.

(b) *Transactions Requiring a State-Certified Appraiser.*

(1) (All transactions of $1,000,000 or more) All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal prepared by a state-certified appraiser.

(2) (Nonresidential transactions) All federally related transactions having a transaction value of more than $50,000, other than those involving appraisals of 1-to-4 family residential properties, shall require an appraisal prepared by a state-certified appraiser.

(3) (Complex residential transactions of $250,000 or more) All complex 1-to-4 family residential property appraisals rendered in connection with federally related transactions shall require a state-certified appraiser if the transaction value is $250,000 or more. A regulated institution may presume that appraisals of 1-to-4 family residential properties are not complex unless the institution has readily available information that a given appraisal will be complex. The regulated institution shall be responsible for making the final determination of whether the appraisal is complex. If, during the course of the appraisal, a licensed appraiser identifies factors that would result in the property, form of ownership, or market conditions being considered atypical, then either:

(i) the regulated institution may ask the licensed appraiser to complete the appraisal and have a certified appraiser approve and cosign the appraisal; or

(ii) the institution may engage a certified appraiser to complete the appraisal.

(c) *Transactions Requiring Either a State-Certified or -Licensed Appraiser.* All appraisals for federally related transactions not requiring the services of a state-certified appraiser shall be prepared by either a state-certified appraiser or a state-licensed appraiser.

(d) *Valuation requirement.* Secured transactions exempted from appraisal requirements pursuant to paragraphs (a)(1) and (a)(5) of this section and not otherwise exempted from this regulation or fully insured shall be supported by a written estimate of market value, as defined in this part, performed by an individual having no direct or indirect interest in the property, and qualified and experienced to perform such estimates of value for the type and amount of credit being considered.

(e) *Appraisals to address safety and soundness concerns.* NCUA reserves the right to require an appraisal under this part whenever the agency believes it is necessary to address safety and soundness concerns.

§ 722.4 Minimum appraisal standards.

For federally related transactions, all appraisals shall, at a minimum:

(a) Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation, 1029 Vermont Ave., NW., Washington, DC 20005;

(b) Be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;

(c) Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units;

(d) Be based upon the definition of market value as set forth in § 722.2(f); and

(e) Be performed by State licensed or certified appraisers in accordance with requirements set forth in this part.

§ 722.5 Appraiser Independence.

(a) *Staff Appraiser.* If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the credit union, the credit union shall take appropriate steps to ensure that the appraisers exercise independent judgment. Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with federally related transactions in which the appraiser is otherwise involved.

(b) *Fee Appraisers.* (1) If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the credit union or its agent and have

no direct or indirect interest, financial or otherwise, in the property or the transaction.

(2) A credit union also may accept an appraisal that was prepared by an appraiser engaged directly by another financial services institution; if:

(i) the appraiser has no direct or indirect interest, financial or otherwise, in the property or transaction; and

(ii) the credit union determines that the appraisal conforms to the requirement of this part and is otherwise acceptable.

§ 722.6 Professional Association Membership; Competency.

(a) *Membership in Appraisal Organization.* A state-certified appraiser or a state-licensed appraiser may not be excluded from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization.

(b) *Competency.* All staff and fee appraisers performing appraisals in connection with federally related transactions must be state-certified or -licensed as appropriate. However, a state-certified or -licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered.

§ 722.7 Enforcement.

Credit unions and institution-affiliated parties, including staff appraisers, may be subject to removal and/or prohibition orders, cease-and-desist orders, and the imposition of civil money penalties pursuant to Section 1786 of the Federal Credit Union Act, or any other applicable law.

Part 724

Trustees and Custodians of Pension Plans

§ 724.1 Federal Credit Unions Acting as Trustees and Custodians of Pension Plans.

A Federal credit union is authorized to act as trustee or custodian, and may receive reasonable compensation for so acting, under any written trust instrument or custodial agreement created or organized in the United States and forming part of a pension plan which qualifies or qualified for specific tax treatment under section 401(d) or 408 of the Internal Revenue Code, for its members or groups of its members, provided the funds of such plans are invested in share accounts or share certificate accounts of the Federal credit union. All funds held in a trustee or custodial capacity must be maintained in accordance with applicable laws and rules and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other authority exercising jurisdiction over such trust or custodial accounts. The Federal credit union shall maintain individual records for each participant which show in detail all transactions relating to the funds of each participant or beneficiary.

§ 724.2 Self-Directed Retirement Plans.

A Federal credit union may act as trustee or custodian of individual retirement plans of its members established pursuant to section 401(d) or 408 of the Internal Revenue Code, and may facilitate transfers of plan funds to assets other than share and share certificates of the credit union, provided the conditions of Section 724.1 and the following additional conditions are met:

(a) all contributions of funds are initially made to a share or share certificate account in the Federal credit union;

(b) any subsequent transfer of funds to other assets is solely at the direction of the member and the Federal credit union exercises no investment discretion and provides no investment advice with respect to plan assets (i.e., the credit union performs only custodial duties); and

(c) the member is clearly notified of the fact that National Credit Union Share Insurance Fund coverage is limited to funds held in share or share certificate accounts of NCUSIF-insured credit unions.

§ 724.3 Appointment of Successor Trustee or Custodian.

Any plan operated pursuant to this Part shall provide for the appointment of a successor trustee or custodian by a person, committee, corporation, or organization other than the Federal credit union or any person acting in his capacity as a director, employee or agent of the Federal credit union upon notice from the Federal credit union or the Board that the Federal credit union is unwilling or unable to continue to act as trustee or custodian.

Part 725

Central Liquidity Facility

§ 725.1 Scope.

This Part contains the regulations implementing the National Credit Union Central Liquidity Facility Act, Subchapter III of the Federal Credit Union Act. The National Credit Union Administration Central Liquidity Facility is a mixed-ownership Government corporation within the National Credit Union Administration. It is managed by the National Credit Union Administration Board and is owned by its member credit unions. The purpose of the Facility is to improve the general financial stability of credit unions by meeting their liquidity needs and thereby encourage savings, support consumer and mortgage lending and provide basic financial resources to all segments of the economy.

§ 725.2 Definitions.

As used in this Part:

(a) "Agent" means an Agent member of the Facility.

(b) "Agent group" means an Agent member of the Facility consisting of a group of central credit unions, one of which is designated as the group's "Agent group representative" and authorized to transact business with the Facility on behalf of the group or any member of the group.

(c) "Agent loan" means an advance of funds by an Agent to a member natural person credit union to meet liquidity needs which have been the basis for a Facility advance.

(d) "Central credit union" means a Federal or state-chartered credit union primarily serving other credit unions. A credit union is primarily serving other credit unions when the total dollar amount of the shares and deposits received from other credit unions plus loans to other credit unions exceeds 50 percent of the total dollar amount of all shares and deposits plus loans during the qualifying period, as defined in subsection (p) of this section.

(e) "Facility" or "Central Liquidity Facility" means the National Credit Union Administration Central Liquidity Facility.

(f) "Facility advance" means an advance of funds by the Facility to a Regular or Agent member.

(g) "Facility lending officer" means any employee of the Facility or the National Credit Union Administration who has been designated by the NCUA Board as a Facility lending officer.

(h) "Liquid assets" means the following unpledged assets:

(1) cash on hand;

(2) share or deposit accounts with remaining maturities of one year or less maintained in central credit unions or institutions insured by the Federal Deposit Insurance Corporation or Federal Savings and Loan Insurance Corporation;

(3) investments in obligations of the United States or any agency thereof, or securities fully guaranteed as to principal and interest thereby, which are authorized under 12 U.S.C. § 1757(7) and which have a remaining maturity of one year or less;

(4) common trust investments and similar investments in funds or securities authorized for Federal credit unions, the objectives of which are to provide daily liquidity for participating credit unions;

(5) shares in the National Credit Union Administration Central Liquidity Facility or in special share accounts authorized by Section 725.7 of this Part;

(6) in the case of a federally-insured state-chartered credit union, any asset held in satisfaction of liquidity requirements imposed by applicable state law or regulation; and

(7) balances maintained by federally-insured credit unions in a Federal Reserve bank, or in a pass-through account to a Federal Reserve bank, pursuant to the requirements of Section 19(b) of the Federal Reserve Act (12 U.S.C. § 461(b)).

(i) "Liquidity needs" means the needs of credit unions primarily serving natural persons for:

(1) short-term adjustment credit available to assist in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly adjustment of credit union assets and liabilities;

(2) seasonal credit available for longer periods to assist in meeting seasonal needs for

funds arising from a combination of expected patterns of movement in share and deposit accounts and loans; and

(3) protracted adjustment credit available in the event of unusual or emergency circumstances of a longer term nature resulting from national, regional or local difficulties.

(j) "Management policies" means policies of a credit union with respect to membership, shares, deposits, dividends, interest rates, lending, investing, borrowing, safeguarding of assets, hiring, training and supervision of employees, and general operating and control practices and procedures.

(k) "Member" means a Regular or Agent member of the Facility, unless the context indicates otherwise.

(l) "Member natural person credit union" means a natural person credit union which is a member of an Agent or of any central credit union in an Agent group. Member natural person credit unions are not members of the Facility unless they are also Regular members of the Facility.

(m) "Natural person credit union" means a Federal or state-chartered credit union primarily serving natural persons. A credit union is primarily serving natural persons if it is not a central credit union as defined in subsection (d) of this section.

(n) "NCUA Board" or "Board" means the National Credit Union Administration Board.

(o) "Paid-in and unimpaired capital and surplus" means the balance of the paid-in share accounts and deposits as of a given date, less any loss that may have been incurred for which there is no reserve or which has not been charged against undivided earnings, plus the credit balance (or less the debit balance) of the undivided earnings account as of a given date, after all losses have been provided for and net earnings or net losses have been added thereto or deducted therefrom. Statutory reserves or special agreement between the credit union and its regulatory authority or between the credit union and its member account insurer shall not be considered as part of surplus.

(p) "Qualifying Period" means:

(1) for initial qualification, any 7 months out of the 12 months immediately preceding the month in which application is made to become a member of the Facility; and

(2) for qualification during each subsequent calendar year, any 7 months out of the previous calendar year.

(q) "Stock subscription" means the stock subscription required for membership in the Facility. "Total subscribed Facility stock" is the sum of all members' stock subscriptions.

§ 725.3 Regular Membership.

(a) A natural person credit union may become a Regular member of the Facility by:

(1) making application on a form approved by the Facility;

(2) subscribing to capital stock of the Facility in an amount equal to one-half of 1 percent of the credit union's paid-in and unimpaired capital and surplus, as determined in accordance with subsection 725.5(b) of this Part, and forwarding with its completed application funds equal to one-half of this stock subscription;[1] and

(3) furnishing the following reports and documents with the completed membership application;

(i) a copy of the credit union's financial and statistical report for the most recent calendar month; and

(ii) copies of the credit union's charter and bylaws, unless the credit union is federally chartered.

(b) A credit union which becomes a Regular member of the Facility after February 23, 1980, may not receive Facility advances without approval of the NCUA Board for a period of six months after becoming a member. This subsection shall not apply to any credit union which becomes a Regular member of the Facility within six months after such credit union is chartered, or which has had access to Facility funds through an Agent member of the Facility at any time within six months prior to becoming a Regular member of the Facility.

§ 725.4 Agent Membership.

(a) A central credit union or a group of central credit unions may become an Agent member of the Facility by (in the case of a group of central credit unions, each central credit union in the group must do each of the following except for paragraph (a)(2) of this section, which shall be done by the Agent group representative):

(1) making application on a form approved by the Facility;

[1] A credit union which submits its application for membership prior to October 1, 1979, is not required to forward these funds to the Facility until October 1, 1979.

(2) subscribing to the capital stock of the Facility in an amount equal to one-half of 1 percent of the paid-in and unimpaired capital and surplus (as determined in accordance with subsection 725.5(b) of this Part) of all the central credit union's or central credit union group's member natural person credit unions, except those which are Regular members of the Facility or which have access to the Facility through, and are included in the stock subcription of, another Agent.[2] Upon approval of the application, the Agent shall forward funds equal to one-half of this initial stock subscription to the Facility;[3]

(3) furnishing the following reports and documents with the completed membership application:

(i) a copy of the central credit union's financial and statistical report for the most recent calendar month;

(ii) copies of the central credit union's charter and bylaws, unless such credit union is federally chartered; and

(iii) a list of all the central credit union's member natural person credit unions.

(4) agreeing to submit to the supervision of the NCUA Board and to comply with all regulations and reporting requirements which the NCUA Board shall prescribe for Agent members;

(5) agreeing to submit to periodic unrestricted examinations by the NCUA Board or its designee; and

(6) obtaining the written approval of the NCUA Board.

(b) The NCUA Board may approve a central credit union or group of central credit unions as an Agent member of the Facility, provided the NCUA Board is satisfied that such credit union or credit union group meets certain criteria, including but not limited to the following (in the case of a group of central credit unions, each central credit union in the group must meet these criteria):

(1) the management policies are in writing, approved by the central credit union's board of directors, and reviewed annually by such board;

(2) adequate internal controls are in place to assure accurate and timely reporting of transactions and the safeguarding of assets;

(3) the financial condition of the central credit union is sound with adequate reserves for losses;

(4) surety bond coverage provides protection for the central credit union while the central credit union is performing the duties of an Agent member of the Facility;

(5) management has demonstrated its ability to use such techniques as cash flow analysis, budgeting, and projections of sources and uses of funds to manage the affairs of the central credit union efficiently and in conformity with sound business practices; and

(6) there are no practices, procedures, policies, or other factors that would result in discrimination by the central credit union among natural person credit unions or inhibit its ability to act independ- ently in its role as an Agent member of the Facility.

(c) Each Agent, or in the case of an Agent group, each central credit union in the group, must:

(1) maintain records related to Facility activity in conformity with requirements prescribed by the NCUA Board from time to time; and

(2) submit such reports as may be required by the Facility to determine financial soundness, quality and level of service, and conformity with established guidelines and procedures.

(d) Each Agent, or in the case of an Agent group, each central credit union in the group, must have on an annual basis a third party independent audit of its books and records and provide the Facility with copies of the report of such audit. The auditor selected must be recognized by a state or territorial licensing authority as possessing the requisite knowledge and experience to perform audits.

(e) Within 30 days after a natural person credit union becomes a member of a central credit union which is an Agent or a member of an Agent group, the agent, or in the case of an Agent group, the agent group representative, shall subscribe to additional capital stock of the Facility in an amount equal to one-half of 1 percent of such credit union's paid-in and unimpaired capital and surplus, and shall forward funds equal to one-half of this stock subscription to the Facility. This subsection shall not apply if the natural person credit union is

[2] A natural person credit union which is a member of more than one Agent member of the Facility must designate through which Agent it will deal with the Facility, and the designated Agent will be responsible for including the capital and surplus of such credit union in the calculation of its stock subscription.

[3] If the application is approved prior to October 1, 1979, these funds are not required to be forwarded to the Facility until October 1, 1979.

a Regular member of the Facility or has access to the Facility through, and is included in the stock subscription of, another Agent.

(f) A central credit union or group of central credit unions which becomes an Agent member of the Facility after February 23, 1980, may not receive a Facility advance without approval of the NCUA Board for a period of six months after becoming a member. This subsection shall not apply to any central credit union which becomes an Agent member or a member of an Agent group within six months after such credit union has been an Agent or a member of another Agent group.

(g) Agent members will be compensated for the services they perform for the Facility in a manner to be specified by the NCUA Board.

§ 725.5 Capital Stock.

(a) The capital stock of the Facility is divided into nonvoting shares having a par value of $50 each. The Facility issues whole and fractional shares. Shares are issued in book entry form upon receipt of payment for such shares, and cannot be transferred or hypothecated except to the Facility.

(b) The capital stock subscriptions provided for in Sections 725.3 and 725.4 shall be:

(1) based on an arithmetic average of paid-in and unimpaired capital and surplus over the six months preceding application for membership, and

(2) adjusted at the close of each calendar year in accordance with an arithmetic average of paid-in and unimpaired capital and surplus over the twelve months in such calendar year. Payments for adjustments to the capital stock subscription must be received by the Facility no later than March 31 of the following year.

(c) That part of a member's stock subscription which is not paid-in shall be held by the member on call of the NCUA Board and shall be invested in liquid assets.

(d) Any member may at any time purchase additional shares of capital stock in the Facility. Any shares in excess of the member's required paid-in portion of its stock subscription can be redeemed by the member as long as the member maintains investments in other assets sufficient to meet the requirement of paragraph (c) of this section. The member's required paid-in portion of its stock subscription includes one-half of its stock subscription plus any "calls" that may have been issued by the NCUA Board against the "on-call" portion of such stock subscription.

(e) Dividends will be paid on capital stock at such times and rates as are determined by the NCUA Board. The NCUA Board shall declare such dividends no less frequently than annually. All issued (paid for) capital stock shall share in dividend distributions without preference. Payment of dividends will be made by the issuance of capital stock to the member in the amount of the dividend.

§ 725.6 Termination of Membership.

(a) A member of the Facility whose stock subscription constitutes less than 5 percent of total subscribed Facility stock may withdraw from membership in the Facility six months after notifying the NCUA Board in writing of its intention to do so.

(b) A member of the Facility whose stock subscription constitutes 5 percent or more of total subscribed Facility stock may withdraw from membership in the Facility twenty-four months after notifying the NCUA Board in writing of its intention to do so.

(c) The NCUA Board may terminate membership in the Facility if, after the opportunity for a hearing, the NCUA Board determines the member has failed to comply with any provision of the National Credit Union Central Liquidity Facility Act or any regulation issued pursuant thereto. If membership is terminated under this subsection, the credit union will be required to obtain the approval of the NCUA Board before becoming a member of the Facility again. Such approval will be granted only if the NCUA Board is satisfied that the credit union will comply with such Act and regulations.

(d)(1) If membership is terminated under any provision of this section, the terminated member's stock shall be redeemed upon termination. In such event, the Facility may retain any amount owed to the Facility by the member.

(2) When a member natural person credit union withdraws from membership in a central credit union which is an Agent or a member of an Agent group, the stock subscription of the Agent, or in the case of an Agent group, the stock subscription of the Agent group representative, will be adjusted after the waiting period which would apply under subsection (a) or (b) of

this section if the withdrawing credit union were a member of the Facility.

§ 725.7 Special Share Accounts in Federally Chartered Agent Members.

(a) A federally chartered Agent member of the Facility may require its member natural person credit unions to establish and maintain special share accounts in the Agent member to reimburse it for the portion of the Agent's Facility stock subscription which is attributable to the paid-in and unimpaired capital and surplus of each such natural person credit union.

(b) The amount which the Agent member requires each member natural person credit union to maintain in such special share accounts shall be based on a uniform percentage of the paid-in and unimpaired capital and surplus of such credit unions, and shall not exceed the amount of the Agent's stock subscription which is attributable to the capital and surplus of each such credit union. An Agent shall not permit a member to maintain in a special share account any amounts in excess of the required amount.

(c) A natural person credit union that withdraws from membership in an Agent member or that becomes a Regular member of the Facility, shall be entitled to the return of all amounts in its special share account upon withdrawal from membership in the Agent or upon becoming a Regular member, as applicable.

[Sections 725.8 through 725.16 Reserved for future use.]

§ 725.17 Applications for Extensions of Credit.

(a) A Regular member may apply for a Facility advance to meet its liquidity needs by filing an application on a Facility-approved form, or by any other method approved by the Facility.

(b)(1) An Agent member may apply for a Facility advance by filing an application on a Facility-approved form, or by any other method approved by the Facility.[4]

(2) The Agent's application shall be based on the following:

(i) approved applications to the Agent by its member natural person credit unions for pending loans to meet liquidity needs; or

(ii) outstanding loans previously made by the Agent to meet liquidity needs of its member natural person credit unions; or

(iii) such other demonstrable liquidity needs as the NCUA Board may specify.

(3) An Agent shall not submit an application to the Facility based on the liquidity needs of any member natural person credit union which has not agreed to the repayment, security and credit reporting terms prescribed by the Facility for Agent loans;

(4) Any loan to meet liquidity needs which have been or will be the basis for an application by the Agent for a Facility advance must be applied for on an application form approved by the Facility.

(5) Unless approved by the Facility, an Agent shall not submit an application to the Facility based on the liquidity needs of any credit union which became a member natural person credit union of the Agent after February 23, 1980, unless such credit union has been a member natural person credit union of the Agent for six months, was chartered within six months before becoming a member natural person credit union of the Agent, or had access to the Facility either as a Regular member or through another Agent within six months before becoming a member natural person credit union of the Agent.

(c) In emergency circumstances, the applications for extensions of credit required under subsection (a) and paragraphs (b)(1) and (b)(4) of this section may be verbal, but must be confirmed within five working days by an application as required by such subsection or paragraphs.

(d) Applications of Regular and Agent members shall be filed with a Facility lending officer. Each application for credit which is completed and properly filed will be approved or denied within five working days after the receipt.

§ 725.18 Creditworthiness.

(a) Prior to Facility approval of each application of a Regular member for a Facility advance, the Facility shall consider the creditworthiness of such member.

(b) Prior to an Agent's approval of each application of a member natural person credit union for an extension of credit on which an application by

[4] If the Agent is an Agent group, the application must be filed by the Agent group representative, and any Facility advance will be made to the Agent group representative.

the Agent to the Facility will be based, an Agent shall consider the creditworthiness of such member natural person credit union.

(c) Specific characteristics of an uncreditworthy credit union include, but are not limited to, insolvency as defined by Section 700.1(k) of this Chapter, unsatisfactory practices in extending credit, lower than desirable reserve levels, high expense ratio, failure to repay previous Facility advances as agreed, excessive dependence on borrowed funds, inadequate cash management policies and planning, or any other relevant characteristics creating a less than satisfactory condition. The presence of one or more of these characteristics will not necessarily mean that a credit union will be considered uncreditworthy.

(d) A natural person credit union (whether a Regular member of the Facility or a member natural person credit union) which does not meet the Facility creditworthiness standards may be limited in or denied the use of advances for its liquidity needs.

§ 725.19 Collateral Requirements.

(a) Each Facility advance to a Regular member shall be secured by a security interest in all the assets of the Regular member.

(b) Each Agent loan shall be secured by a security interest in all the assets of the member natural person credit union which receives the loan.

(c) Each Facility advance to an Agent member shall be secured, directly or indirectly, by all the Agent loans made by the Agent member, and by the collateral securing such loans.

§ 725.20 Repayment, Security and Credit Reporting Agreements; Other Terms and Conditions.

(a) Regular and Agent members, or in the case of an Agent group, the Agent group representative, shall sign the repayment, security and credit reporting agreements prescribed by the Facility, and all Facility advances to Regular and Agent members shall be governed by the terms and conditions of such agreements.

(b) All Agent loans shall be made subject to the repayment, security and credit reporting terms prescribed by the Facility for Agent loans.

(c) Other terms and conditions applicable to Facility advances and Agent loans will be specified in confirmations of credit provided in connection with such advances and loans, and/or in operating circulars of the Facility.

§ 725.21 Modification of Agreements.

The repayment, security, and credit reporting terms under which Facility advances and Agent loans will be made, as provided in section 725.20 of this Part, shall be subject to modification from time to time as the NCUA Board may determine. Any change in such terms shall be published in the FEDERAL REGISTER and shall apply to all advances disbursed by the Facility after the effective date of the change.

§ 725.22 Advances to Insurance Organizations.

(a) In accordance with policies established by the NCUA Board, the Facility may advance funds to a State credit union share or deposit insurance corporation, guaranty credit union, guaranty association, or similar organization. Requests for such advances shall be supported by an application which sets forth and supports the need for the advance.

(b) Advances under subsection (a) shall be subject to the approval of the NCUA Board and shall be made subject to the following terms:

(1) the advance shall be fully secured,

(2) the maturity of the advance shall not exceed 12 months,

(3) the advance shall not be renewable at maturity, and

(4) the funds advanced shall not be relent at an interest rate exceeding that imposed by the Facility

§ 725.23 Other Advances.

(a) The NCUA Board may authorize extensions of credit to members of the Facility for purposes other than liquidity needs if the NCUA Board, the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury concur in a determination that such extensions of credit are in the national economic interest.

(b) Extensions of credit approved under the conditions of paragraph (a) of this section shall be subject to such terms and conditions as shall be established by the NCUA Board.

Part 740

Advertising

§ 740.0 Scope.

This part applies to all federally-insured credit unions. It prescribes the requirements with regard to the official sign insured credit unions must display and the requirements with regard to the official advertising statement insured credit unions must include in their advertisements. It also prescribes a general requirement that all other kinds of advertisements must be accurate.

§ 740.1 Definitions.

(a) "Account" or "accounts" as used in this Part means share, share certificate or share draft accounts (or their equivalent under state law, as determined by the Board in the case of insured state credit unions) of a member (which includes other credit unions, public units, and nonmembers where permitted under the Act) in a credit union of a type approved by the Board which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member.

(b) "Insured credit union" as used in this Part means a credit union insured by the National Credit Union Administration (NCUA).

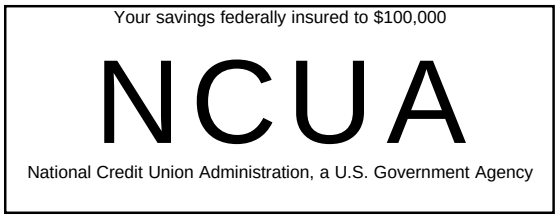
§ 740.2 Accuracy of Advertising.

No insured credit union shall use any advertising (which includes print or broadcast media, displays and signs, stationery, and all other promotional material) or make any representation which is inaccurate or deceptive in any particular, or which in any way misrepresents its services, contracts, or financial condition, or which violates the requirements of § 707.8 of this subchapter, if applicable. Any advertising that mentions share or savings account insurance provided by a party other than the NCUA must clearly explain the type and amount of such insurance and the identity of the carrier, and must avoid any statement or implication that the carrier is affiliated with the NCUA or the Federal government.

§ 740.3 Mandatory Requirements with Regard to the Official Sign and its Display.

(a) Each insured credit union shall continuously display the official sign described in paragraph (b) at each station or window where insured account funds or deposits are usually and normally received in its principal place of business and in all its branches 30 days after its first day of operation as an insured credit union.

(b) The official sign shall be as depicted below, having a blue background with white lettering:



(1) All insured credit unions will automatically be furnished an initial supply of official signs, at no cost, from the Administration for compliance with paragraph (a) of this section. If the initial supply is not adequate, an immediate request for additional signs must be made. Any credit union that does not have an adequate supply but requests additional signs from NCUA shall not be deemed to have violated paragraph (a) unless the credit union shall omit to display the signs after receipt thereof.

(2) Additional signs reflecting variations in color, materials and size, for use other than as prescribed in paragraph (a) of this section may be procured by insured credit unions from commercial suppliers.

(c) An insured credit union shall not receive account funds at any teller's station or window where any noninsured credit union or institution receives deposits. Excepted from this prohibition are credit union centers, service centers, or branches servicing more than one credit union where only some of the credit unions are insured by the NCUA. In such instances there must be placed imme-

diately above or beside each official sign another sign stating "Only the following credit unions serviced by this facility are federally insured by the NCUA " (the full name of each credit union insured will follow the word NCUA). The lettering will be of such size and print to be clearly legible to all members conducting share or share deposit transactions.

(d) The Board may require any insured credit union, upon at least 30 days' written notice, to change the wording of its official signs in a manner deemed necessary for the protection of shareholders or others.

(e) For purposes of this section, the terms "branch," "station," "teller station," and "window" do not include automated teller machines or point of sale terminals.

§ 740.4 Mandatory Requirements with Regard to the Official Advertising Statement and Manner of Use.

(a) Each insured credit union shall include the official advertising statement, prescribed in paragraph (b) of this section, in all of its advertisements except as provided in paragraph (c) of this section.

(1) An insured credit union must include the official advertising statement in its advertisements thirty (30) days after its first day of operations as an insured credit union unless it has been granted an extension by the Regional Director.

(2) In cases where advertising copy not including the official advertising statement is on hand on the date the requirements of this section become operative, the insured credit union may cause the official advertising statement to be included by use of overstamp or by other means until the supplies are exhausted.

(b) The official advertising statement shall be in substance as follows: "This credit union is federally insured by the National Credit Union Administration." The short title "Federally insured by NCUA" and a reproduction of the official sign may be used by insured credit unions at their option as the official advertising statement. The official advertising statement shall be of such size and print to be clearly legible.

(c) The following advertisements need not include the official advertising statement:

(1) Statements of condition and reports of condition of an insured credit union which are required to be published by State and Federal law or regulation;

(2) Credit union supplies such as stationery (except when used for circular letters), envelopes, deposit slips, checks, drafts, signature cards, account passbooks, and noninsurable certificates, etc.;

(3) Signs or plates in the credit union office or attached to the building or buildings in which the offices are located;

(4) Listings in directories;

(5) Advertisements not setting forth the name of the insured credit union;

(6) Display advertisements in credit union directories, provided the name of the credit union is listed on any page in the directory with a symbol or other descriptive matter indicating it is insured;

(7) Joint or group advertisements of credit union services where the names of insured credit unions and noninsured credit unions are listed and form a part of such advertisement;

(8) Advertisements by radio which do not exceed thirty (30) seconds in time;

(9) Advertisements by television, other than display advertisement, which do not exceed thirty (30) seconds in time;

(10) Advertisements which are of the type or character making it impractical to include thereon the official advertising statement, including but not limited to, promotional items such as calendars, matchbooks, pens, pencils, and key chains;

(11) Advertisements which contain a statement to the effect that the credit union is insured by the National Credit Union Administration, or that its accounts and shares or members are insured by the Administration to the maximum of $100,000 for each member or shareholder;

(12) Advertisements which do not relate to member accounts, including but not limited to:

(i) Advertisements relating specifically and only to the making of loans by the credit union or loan services;

(ii) Advertisements relating specifically and only to safekeeping box business or services;

(iii) Advertisements relating specifically and only to traveler's checks on which the credit union issuing or causing to be issued the advertisement is not primarily liable; and

(iv) Advertisements relating specifically and only to loan life insurance.

(d) The non-English equivalent of the official advertising statement may be used in any advertisement: Provided, That the translation has had the prior written approval of the Regional Director.

Part 741

Requirements for Insurance

§ 741.0 Scope.

The provisions of this part apply to federal credit unions, federally insured state-chartered credit unions, and credit unions making application for insurance of accounts pursuant to Title II of the Act, unless the context of a provision indicates its application is otherwise limited. This part prescribes various requirements for obtaining and maintaining federal insurance and the payment of insurance premiums and capitalization deposit. Subpart A of this part contains substantive requirements that are not codified elsewhere in this chapter. Subpart B of this part lists additional regulations, set forth elsewhere in this chapter as applying to federal credit unions, that also apply to federally insured state-chartered credit unions. As used in this part, "insured credit union" means a credit union whose accounts are insured by the National Credit Union Share Insurance Fund (NCUSIF).

Subpart A—Regulations that Apply to Both Federal Credit Unions and Federally Insured State-Chartered Credit Unions and That are not Codified Elsewhere in NCUA's Regulations

§ 741.1 Examination.

As provided in Sections 201 and 204 of the Act (12 U.S.C. 1781 and 1784), the NCUA Board is authorized to examine any insured credit union or any credit union making application for insurance of its accounts. Such examination may require access to all records, reports, contracts to which the credit union is a party, and information concerning the affairs of the credit union. Upon request, such documentation must be provided to the NCUA Board or its representative. Any credit union which makes application for insurance will be required to pay the cost of such examination and processing. To the maximum extent feasible, the NCUA Board will utilize examinations conducted by state regulatory agencies.

§ 741.2 Maximum borrowing authority.

Any credit union which makes application for insurance of its accounts pursuant to Title II of the Act, or any insured credit union, must not borrow, from any source, an aggregate amount in excess of 50 per centum of its paid-in and unimpaired capital and surplus (shares and undivided earnings, plus net income or minus net loss).

§ 741.3 Criteria.

In determining the insurability of a credit union which makes application for insurance and in continuing the insurability of its accounts pursuant to Title II of the Act, the following criteria shall be applied:

(a) *Adequacy of reserves.*

(1) *General rule.* State-chartered credit unions must meet, at a minimum, the statutory reserve and full and fair disclosure requirements imposed on federal credit unions by Section 116 of the Act and part 702 of this chapter.

(2) *Charges against reserves.* State-chartered credit unions may charge losses, including losses other than loan losses, against the statutory reserve in accordance with either state law or procedures established by the state supervisory authority. However, charges for losses other than loan losses shall be made only after notification to the Regional Director, unless the credit union's ratio of capital to assets is greater than 6 percent and the charge reduces the ratio by no more than ½ percent. For purposes of this section, capital is defined as the total of the Regular Reserve, the Allowance for Loan Losses, the Allowance for Investment Losses, Undivided Earnings, and other reserves.

(3) *Special reserve for nonconforming investments.* State-chartered credit unions (except state-chartered corporate credit unions) are required to establish an additional special reserve for investments if those credit unions are permitted by their respective state laws to make investments beyond those authorized in

the Act or the NCUA Rules and Regulations. For any investment other than loans to members and obligations or securities expressly authorized in Title I of the Act and part 703 of this chapter, as amended, state-chartered credit unions (except state-chartered corporate credit unions) are required to establish and maintain at the end of each accounting period and prior to payment of any dividend, an Investment Valuation Reserve Account in an amount at least equal to the net excess of book value over current market value of the investments. If the market value cannot be determined, an amount equal to the full book value will be established. When at the end of any dividend period, the amount in the Investment Valuation Reserve exceeds the difference between book value and market value, the board of directors may authorize the transfer of the excess to Undivided Earnings.

(b) *Financial condition and policies.* The following factors are to be considered in determining whether the credit union's financial condition and policies are both safe and sound:

(1) The existence of unfavorable trends which may include excessive losses on loans (i.e., losses which exceed the regular reserve or its equivalent [in the case of state-chartered credit unions] plus other irrevocable reserves established as a contingency against losses on loans), the presence of special reserve accounts used specifically for charging off loan balances of deceased borrowers, and an expense ratio so high that the required transfers to reserves create a net operating loss for the period or that the net gain after these transfers is not sufficient to permit the payment of a nominal dividend;

(2) The existence of written lending policies, including adequate documentation of secured loans and the protection of security interests by recording, bond, insurance, or other adequate means, adequate determination of the financial capacity of borrowers and co-makers for repayment of the loan, and adequate determination of value of security on loans to ascertain that said security is adequate to repay the loan in the event of default;

(3) Investment policies which are within the provisions of applicable law and regulations, i.e., the Act and part 703 of this chapter for federal credit unions and the laws of the state in which the credit union operates for state-chartered credit unions, except state-chartered corporate credit unions. State-chartered corporate credit unions are permitted to make only those investments that are in conformance with part 704 of this chapter and applicable state laws and regulations;

(4) The presence of any account or security, the form of which has not been approved by the Board, except for accounts authorized by state law for state-chartered credit unions.

(c) *Fitness of management.* The officers, directors, and committee members of the credit union must have conducted its operations in accordance with provisions of applicable law, regulations, its charter and bylaws. No person shall serve as a director, officer, committee member, or employee of an insured credit union who has been convicted of any criminal offense involving dishonesty or breach of trust, except with the written consent of the Board.

(d) *Insurance of member accounts would not otherwise involve undue risk to the NCUSIF.* The credit union must maintain adequate fidelity bond coverage as specified in § 741.201. Any circumstances which may be unique to the particular credit union concerned shall also be considered in arriving at the determination of whether or not an undue risk to the NCUSIF is or may be present. For purposes of this section, the term "undue risk to the NCUSIF" is defined as a condition which creates a probability of loss in excess of that normally found in a credit union and which indicates a reasonably foreseeable probability of the credit union becoming insolvent because of such condition, with a resultant claim against the NCUSIF.

(e) *Powers and purposes.* The credit union must not perform services other than those which are consistent with the promotion of thrift and the creation of a source of credit for its members, except as otherwise permitted by law or regulation.

(f) *Letter of disapproval.* A credit union whose application for share insurance is disapproved shall receive a letter indicating the reasons for such disapproval, a citation of the authority for such disapproval, and suggested methods by which the applying credit union may correct its deficiencies and thereby qualify for share insurance.

(g) Nothing in this section shall preclude the NCUA Board from imposing additional terms or conditions pursuant to the insurance agreement.

§ 741.4 Insurance premium and one percent deposit.

(a) *Scope.* This section implements the requirements of Section 202 of the Act (12 U.S.C. 1782) providing for capitalization of the NCUSIF through the maintenance of a deposit by each insured credit union in an amount equaling one percent of its insured shares and payment of an annual insurance premium.

(b) *Definitions.* For purposes of this section:

(1) *Insurance year* means the period from January 1 through December 31;

(2) *Insured shares* means the total amount of a credit union's share, share draft and share certificate accounts, or their equivalent under state law (which may include deposit accounts), authorized to be issued to members, other credit unions, public units, or nonmembers (where permitted under the Act or equivalent state law). "Insured shares" does not include amounts in excess of insurance coverage as provided in part 745 of this chapter; and

(3) *Normal operating level* means a total value of the NCUSIF equity equaling 1.3 percent of the aggregate of all insured shares in insured credit unions as of the end of the preceding insurance year, or such lower value as established by action of the NCUA Board.

(c) *One percent deposit.* Each insured credit union shall maintain with the NCUSIF during each insurance year a deposit in an amount equaling one percent of the total of the credit union's insured shares as of the close of the preceding insurance year. The deposit amount shall be adjusted annually on a date to be determined by the NCUA Board.

(d) *Premium.* Unless waived by the NCUA Board, each insured credit union shall pay to the NCUSIF, on a date to be determined by the NCUA Board, an insurance premium for that insurance year in an amount equaling one-twelfth of one percent of the credit union's total insured shares as of the close of the preceding insurance year.

(e) *Redistribution of NCUSIF equity.* When the NCUSIF exceeds its normal operating level, the NCUA Board will, at least annually, make a proportionate adjustment for insured credit unions of the amount necessary to reduce the NCUSIF to its normal operating level. Such adjustment will be in the form determined by the NCUA Board and may include a waiver of insurance premiums, premium rebates, and/or distributions from NCUSIF equity.

(f) *Forms 1304 and 1305.* A certified copy of Form 1304 will be provided to all federally insured state-chartered credit unions and Form 1305 to all federally chartered credit unions in connection with the computation and funding of their annual premium payment and any change in their one percent deposit. Form 1305 also includes the annual operating fee. Forms 1304 and 1305 are invoices and are precalculated based on the credit union's previous year's insured shares. The forms provide for any adjustments declared by the NCUA Board, resulting in a single net transfer of funds between the credit union and the NCUA. Additional copies of each credit union's Form 1304 and 1305 may be obtained from the appropriate NCUA Regional Office.

(g) *New charters.* A newly-chartered credit union that obtains share insurance coverage from the NCUSIF during the insurance year in which it has obtained its charter shall not be required to pay an insurance premium for that insurance year. The credit union shall fund its one percent deposit on a date to be determined by the NCUA Board in the following insurance year, but shall not participate in any distribution from NCUSIF equity related to the period prior to the credit union's funding of its deposit.

(h) *Conversion to Federal insurance.* An existing credit union that converts to insurance coverage with the NCUSIF during an insurance year shall immediately fund its one percent deposit based on the total of its shares as of the close of the month prior to conversion and shall pay a premium (unless waived in whole or in part for all insured credit unions during that year) in an amount that is prorated to reflect the remaining number of months in the insurance year. The credit union will be entitled to a prorated share of any distribution from NCUSIF equity declared subsequent to the credit union's conversion.

(i) *Mergers of nonfederally insured credit unions.* Where a nonfederally insured credit union merges into a federally insured credit union, the continuing federally insured credit union shall immediately pay to the NCUSIF a prorated insurance premium (unless waived in whole or in part for all federally insured credit unions), and an additional one percent deposit based upon the increase in insured shares resulting from the merger.

(j) *Return of deposit.* Any insolvent credit union that is closed for involuntary liquidation will not be entitled to a return of its deposit. Any solvent credit union that is closed due to involuntary liquidation shall be entitled to a return of its deposit prior to final distribution of member shares. Any

other credit union whose insurance coverage with the NCUSIF terminates will be entitled to a return of the full amount of its deposit immediately after the final date on which any shares of the credit union are insured, except that the NCUA Board reserves the right to delay payment by up to one year if it determines that immediate payment would jeopardize the financial condition of the NCUSIF. This includes termination of insurance due to mergers and consolidations. A credit union that receives a return of its deposit during an insurance year shall have the option of leaving a nominal sum on deposit with the NCUSIF until the next distribution from NCUSIF equity and will thus qualify for a prorated share of the distribution.

(k) *Assessment of administrative fee and interest for delinquent payment.* Each federally insured credit union shall pay to the NCUA an administrative fee, the costs of collection, and interest on any delinquent payment of its capitalization deposit or insurance premium. A payment will be considered delinquent if it is postmarked later than the date stated in the invoice provided to the credit union. The NCUA may waive or abate charges or collection of interest, if circumstances warrant.

(1) The administrative fee for a delinquent payment shall be an amount as fixed from time to time by the NCUA Board based upon the administrative costs of such delinquent payments to the NCUA in the preceding year.

(2) The costs of collection shall be calculated as the actual hours expended by NCUA personnel multiplied by the average hourly cost of the salaries and benefits of such personnel.

(3) The interest rate charged on any delinquent payment shall be the U.S. Department of the Treasury Tax and Loan Rate in effect on the date when the payment is due as provided in 31 U.S.C. 3717.

§ 741.5 Notice of termination of excess insurance coverage.

In the event of a credit union's termination of share insurance coverage other than that provided by the NCUSIF, the credit union must notify all members in writing of such termination at least thirty days prior to the effective date of termination.

§ 741.6 Financial and statistical and other reports.

(a) Each operating insured credit union with assets in excess of $50,000,000 shall file with the NCUA a quarterly Financial and Statistical Report on Form NCUA 5300, on or before January 22 (as of the previous December 31), April 22 (as of the previous March 31), July 22 (as of the previous June 30) and October 22 (as of the previous September 30) of each year. All other operating insured credit unions shall file with the NCUA on or before January 31 and on or before July 31 of each year a semiannual Financial and Statistical Report on Form NCUA 5300, as of the previous December 31 (in the case of the January filing) or June 30 (in the case of the July filing).

(b) Insured credit unions shall, upon written notice from the NCUA Board or Regional Director, file such financial or other reports in accordance with instructions contained in such notice.

§ 741.7 Conversion to a state-chartered credit union.

Any federal credit union that petitions to convert to a state-chartered federally insured credit union is required to apply to the Regional Director for continued insurance of its accounts and meet the requirements as stated in the Act and this part. If the application for continued insurance is not approved, such insurance will terminate subject to the conditions set forth in section 206(d) of the Act.

§ 741.8 Purchase of assets and assumption of liabilities.

(a) Any credit union insured pursuant to Title II of the Act must apply for and receive approval from the NCUA Board before either purchasing or acquiring loans or assuming or receiving an assignment of deposits, shares, or liabilities from:

(1) Any credit union that is not insured pursuant to Title II of the Act;

(2) Any other financial-type institution (including depository institutions, mortgage banks, consumer finance companies, insurance companies, loan brokers, and other loan sellers or liability traders); or

(3) Any successor in interest to any institution identified in paragraph (a)(1) or (a)(2) of this section.

(b) Approval is not required for:

(1) Purchases of student loans or real estate secured loans to facilitate the packaging of a pool of loans to be sold or pledged on the secondary market under § 701.23(b)(1) (iii) or (iv) of this chapter or comparable state law for state-chartered credit unions, or purchases of member loans under § 701.23(b)(1)(i) of this chapter or comparable state law for state-chartered credit unions; or

(2) Assumptions or receipt of deposits, shares or liabilities as rollovers or transfers of member retirement accounts or in which an NCUSIF-insured credit union perfects a security interest in connection with an extension of credit to any member.

§ 741.9 Uninsured membership shares.

Any credit union that is insured pursuant to Title II of the Act may not offer membership shares that, due to the terms and conditions of the account, are not eligible for insurance coverage. This prohibition does not apply to shares that are uninsured solely because the amount is in excess of the maximum insurance coverage provided pursuant to part 745 of this chapter.

§ 741.10 Disclosure of share insurance.

Any credit union which is insured pursuant to Title II of the Act and is permitted by state law to accept nonmember shares or deposits from sources other than other credit unions and public units (or, for low-income designated credit unions, any nonmembers), shall identify such nonmember accounts as nonmember shares or deposits on any statement or report required by the NCUA Board for insurance purposes. Immediately after a state-chartered credit union receives notice from NCUA that its member accounts are federally insured, the credit union shall advise any present nonmember share and deposit holders by letter that their accounts are not insured by the NCUSIF. Also, future nonmember share and deposit fund holders will be so advised by letter as they open accounts.

Subpart B—Regulations Codified Elsewhere in NCUA's Regulations as Applying to Federal Credit Unions That Also Apply to Federally Insured State-Chartered Credit Unions

§ 741.201 Minimum fidelity bond requirements.

(a) Any credit union which makes application for insurance of its accounts pursuant to Title II of the Act must possess the minimum fidelity bond coverage stated in § 701.20 of this chapter in order for its application for such insurance to be approved and for such insurance coverage to continue. A federally insured credit union whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination.

(b) Corporate credit unions must comply with § 704.17 of this chapter in lieu of § 701.20 of this chapter.

§ 741.202 Audit and verification requirements.

(a) The supervisory committee of each credit union insured pursuant to Title II of the Act shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the requirements set forth in §§ 701.12 and 701.13 of this chapter.

(b) Each credit union which is insured pursuant to Title II of the Act shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in §§ 701.12(e) and 701.13 of this chapter.

§ 741.203 Minimum loan policy requirements.

Any credit union which is insured pursuant to Title II of the Act must:

(a) Adhere to the requirements stated in § 701.21(h) of this chapter concerning member business loans, § 701.21(c)(8) of this chapter concerning prohibited fees, and § 701.21(d)(5) of this chapter concerning nonpreferential loans. State-chartered, NCUSIF-insured credit unions in a given state are exempt from these requirements if the state regulatory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board. In nonexempt states, all required NCUA reviews and approvals will be handled in coordination with the state credit union supervisory authority; and

(b) Adhere to the requirements stated in part 722 of this chapter concerning appraisals.

§ 741.204 Maximum public unit and nonmember accounts, and low-income designation.

Any credit union that is insured, or that makes application for insurance, pursuant to Title II of the Act must:

(a) Adhere to the requirements of § 701.32 of this chapter regarding public unit and nonmember accounts, provided it has the authority to accept such accounts. Requests by federally insured state-chartered credit unions for an exemption from the limitation of § 701.32 of this chapter will be made and reviewed on the same basis as that provided in § 701.32 of this chapter for federal credit unions, provided, however that NCUA will not grant an exemption without the concurrence of the appropriate state regulator.

(b) Obtain a low-income designation in order to accept nonmember accounts, other than from public units or other credit unions, provided it has the authority to accept such accounts under state law. The state regulator shall make the low-income designation with the concurrence of the appropriate regional director. The designation will be made and reviewed by the state regulator on the same basis as that provided in § 701.34(a) of this chapter for federal credit unions. Removal of the designation by the state regulator for such credit unions shall be with the concurrence of NCUA.

(c) Receive secondary capital accounts only if the credit has a low-income designation pursuant to paragraph (b) of this section, and then only in accordance with the terms and conditions authorized for Federal credit unions pursuant to § 701.34 of this chapter and to the extent not inconsistent with applicable state law and regulation. State chartered federally insured credit unions offering secondary capital accounts must submit the plan required by § 701.34 to both the state supervisory authority and the NCUA Regional Director.

§ 741.205 Reporting requirements for credit unions that are newly chartered or in troubled condition.

Any federally insured credit union chartered for less than 2 years or any credit union defined to be in troubled condition as set forth in § 701.14(b)(3) of this chapter must adhere to the requirements stated in § 701.14(c) of this chapter concerning the prior notice and NCUA review. Federally insured state-chartered credit unions must submit required information to both the appropriate NCUA Regional Director and their state supervisor. NCUA will consult with the state supervisor before making its determination pursuant to § 701.14 (d)(2) and (f) of this chapter. NCUA will notify the state supervisor of its approval/disapproval no later than the time that it notifies the affected individual pursuant to § 701.14(d)(1) of this chapter.

§ 741.206 Corporate credit unions.

Any corporate credit union insured pursuant to Title II of the Act shall adhere to the requirements of part 704 of this chapter.

§ 741.207 Community development revolving loan program for credit unions.

Any credit union which is insured pursuant to Title II of the Act and is a "participating credit union," as defined in § 705.3 of this chapter, shall adhere to the requirements stated in part 705 of this chapter.

§ 741.208 Mergers of federally insured credit unions: voluntary termination or conversion of insured status.

Any credit union which is insured pursuant to Title II of the Act and which merges with another credit union or non-credit union institution, and any state-chartered credit union which volun-

tarily terminates its status as a federally-insured credit union, or converts from federal insurance to other insurance from a government or private source authorized to insure member accounts, shall adhere to the applicable requirements stated in section 206 of the Act and parts 708a and 708b of this chapter concerning mergers and voluntary termination or conversion of insured status.

§ 741.209 Management official interlocks.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 711 of this chapter concerning management official interlocks, issued under the provisions of the Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.).

§ 741.210 Central liquidity facility.

Any credit union which is insured pursuant to Title II of the Act and is a member of the Central Liquidity Facility, shall adhere to the requirements stated in part 725 of this chapter.

§ 741.211 Advertising.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements prescribed by part 740 of this chapter.

§ 741.212 Share insurance.

(a) Member share accounts received by any credit union which is insured pursuant to Title II of the Act in its usual course of business, including regular shares, share certificates, and share draft accounts, are insured subject to the limitations and rules in subpart A of part 745 of this chapter.

(b) The payment of share insurance and the appeal process applicable to any credit union which is insured pursuant to Title II of the Act are addressed in subpart B of part 745 of this chapter.

§ 741.213 Administrative actions, adjudicative hearings, rules of practice and procedure.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the applicable rules of practice and procedures for administrative actions and adjudicative hearings prescribed by part 747 of this chapter. Subpart E of part 747 of this chapter applies only to federal credit unions.

§ 741.214 Report of crime or catastrophic act and Bank Secrecy Act compliance.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 748 of this chapter.

§ 741.215 Records preservation program.

Any credit union which is insured pursuant to Title II of the Act shall maintain a records preservation program as prescribed by part 749 of this chapter.

§ 741.216 Flood insurance.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 760 of this chapter.

§ 741.217 Truth in savings.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the requirements stated in part 707 of this chapter.

§ 741.218 Involuntary liquidation and creditor claims.

Any credit union which is insured pursuant to Title II of the Act shall adhere to the applicable provisions in part 709 of this chapter. Section 709.3 of this chapter applies only to federal credit unions.

§ 741.219 Investment requirements.

Any credit union which is insured pursuant to Title II of the Act must adhere to the requirements stated in part 703 of this chapter concerning transacting business with corporate credit unions.*

*Section 741.219 becomes effective on January 1, 1998.

Part 745

Share Insurance and Appendix

Subpart A—Clarification and Definition of Account Insurance Coverage

§ 745.0 Scope.

The regulation and appendix contained in this Part describe the insurance coverage of various types of member accounts. In general, all types of member share accounts received by the credit union in its usual course of business, including regular shares, share certificates, and share draft accounts, represent equity and are insured. For the purposes of applying the rules in this Part, it is presumed that the owner of funds in an account is an insured credit union member or otherwise eligible to maintain an insured account in a credit union. These rules do not extend insurance coverage to persons not entitled to maintain an insured account or to account relationships that have not been approved by the Board as an insured account. Where there are multiple owners of a single account, generally only that part which is allocable to the member(s) is insured.

§ 745.1 Definitions.

(a) The terms "account" or "accounts" as used in this Part mean share, share certificate or share draft accounts (or their equivalent under state law, as determined by the Board in the case of insured state credit unions) of a member (which includes other credit unions, public units and nonmembers where permitted under the Act) in a credit union of a type approved by the Board which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member.

(b) The terms "member" or "members" as used in this Part mean those persons enumerated in the credit union's field of membership who have been elected to membership in accordance with the Act or state law in the case of state credit unions. It also includes those nonmembers permitted under the Act to maintain accounts in an insured credit union, including nonmember credit unions and nonmember public units and political subdivisions.

(c) The term "public unit" means the United States, any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Panama Canal Zone, any territory or possession of the United States, any county, municipality, or political subdivision thereof, or any Indian tribe as defined in Section 3(c) of the Indian Financing Act of 1974.

(d) The term "political subdivision" includes any subdivision of a public unit, as defined in (c) above, or any principal department of such public unit, (1) the creation of which subdivision or department has been expressly authorized by state statute, (2) to which some functions of government have been delegated by state statute, and (3) to which funds have been allocated by statute or ordinance for its exclusive use and control. It also includes drainage, irrigation, navigation improvement, levee, sanitary, school or power districts and bridge or port authorities, and other special districts created by state statute or compacts between the states. Excluded from the term are subordinate or nonautonomous divisions, agencies, or boards within principal departments.

§ 745.2 General Principles Applicable in Determining Insurance of Accounts.

(a) General: This Part provides for determination by the Board of the amount of members' insured accounts. The rules for determining the insurance coverage of accounts maintained by members in the same or different rights and capacities in the same insured credit union are set forth in the following provisions of this Part. The Appendix provides examples of the application of these rules to various factual situations. Insofar as rules of local law enter into such determinations, the law of the jurisdiction in which the insured credit union's principal office is located shall govern.

(b) The regulations in this Part in no way are to be interpreted to authorize any type of account that is not authorized by Federal law or regulation

or State law or regulation or by the bylaws of a particular credit union. The purpose is to be as inclusive as possible of all situations.

(c) Records: (1) The account records of the insured credit union shall be conclusive as to the existence of any relationship pursuant to which the funds in the account are deposited and on which a claim for insurance coverage is founded. Examples would be trustee, agent, custodian, or executor. No claim for insurance based on such a relationship will be recognized in the absence of such disclosure.

(2) If the account records of an insured credit union disclose the existence of a relationship which may provide a basis for additional insurance, the details of the relationship and the interest of other parties in the account must be ascertainable either from the records of the credit union or the records of the member maintained in good faith and in the regular course of business.

(3) The account records of an insured credit union in connection with a trust account shall disclose the name of both the settlor (grantor) and the trustee of the trust and shall contain an account signature card executed by the trustee.

(4) The interests of the co-owners of a joint account shall be deemed equal, unless otherwise stated on the insured credit union's records in the case of a tenancy in common.

(d) Valuation of trust interests: (1) Trust interests in the same trust deposited in the same account will be separately insured if the value of the trust interest is capable of determination, without evaluation of contingencies, except for those covered by the present worth tables and rules of calculation for their use set forth in § 20.2031–7 of the Federal Estate Tax Regulations (26 C.F.R. 20.2031–7).

(2) In connection with any trust in which certain trust interests are not capable of evaluation in accordance with the foregoing rule, payment by the Board to the trustee with respect to all such trust interests shall not exceed the basic insured amount of $100,000.

(3) Each trust interest in any trust established by two or more settlors shall be deemed to be derived from each settlor pro rata to his contribution to the trust.

(4) The term "trust interest" means the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, but does not include any interest retained by the settlor.

§ 745.3 Single Ownership Accounts.

(a) Funds owned by an individual and deposited in the manner set forth below shall be added together and insured up to $100,000 in the aggregate.

(1) *Individual accounts.* Funds owned by an individual (or by the husband-wife community of which the individual is a member) and deposited in one or more accounts in the individual's own name shall be insured up to $100,000 in the aggregate.

(2) *Accounts held by agents or nominees.* Funds owned by a principal and deposited in one or more accounts in the name or names of agents or nominees shall be added to any individual account of the principal and insured up to $100,000 in the aggregate.

(3) *Custodial loan accounts.* Loan payments received by a Federal credit union prior to remittance to other parties to whom the loan was sold pursuant to Section 107(13) of the Federal Credit Union Act and Section 701.23 of NCUA's Regulations shall be considered to be funds owned by the borrower and shall be added to any individual accounts of the borrower and insured up to $100,000 in the aggregate.

(b) Funds held by a guardian, custodian, or conservator for the benefit of his ward or for the benefit of a minor under a Uniform Gifts to Minors Act and deposited in one or more accounts in the name of the guardian, custodian, or conservator are insured up to $100,000 in the aggregate, separately from any other accounts of the guardian, custodian, conservator, ward, or minor.

§ 745.4 Testamentary Accounts.

(a) The term "testamentary account" refers to a revocable trust account, tentative or "Totten" trust account, "payable-on-death" account, or any similar account which evidences an intention that the funds shall pass on the death of the owner of the funds to named beneficiary.

(b) If the named beneficiary of a testamentary account is a spouse, child, or grandchild of the owner, the account shall be insured up to $100,000 in the aggregate as to each such beneficiary, separately from any other accounts of the owner or beneficiary, regardless of the membership status of the beneficiary.

(c) If the named beneficiary of a testamentary account is other than the owner's spouse, child, or grandchild, the funds in such account shall be

added to any individual accounts of such owner and insured by $100,000 in the aggregate.

§ 745.5 Accounts Held by Executors or Administrators.

Funds of a decedent held in the name of the decedent or in the name of the executor or administrator of the decedent's estate and deposited in one or more accounts shall be insured up to $100,000 in the aggregate for all such accounts, separately from the individual accounts of the beneficiaries of the estate or of the executor or administrator.

§ 745.6 Accounts Held by a Corporation, Partnership or Unincorporated Association.

Accounts of a corporation, partnership, or unincorporated association engaged in any independent activity shall be insured up to $100,000 in the aggregate. The account of a corporation, partnership, or unincorporated association not engaged in an independent activity shall be deemed to be owned by the person or persons owning such corporation or comprising such partnership or unincorporated association and, for account insurance purposes, the interest of each person in such an account shall be added to any other account individually owned by such person and insured up to $100,000 in the aggregate. For purposes of this section, "independent activity" means an activity other than one directed solely at increasing insurance coverage.

§ 745.7 (Reserved)

§ 745.8 Joint Accounts.

(a) Separate insurance coverage. Accounts owned jointly, whether as joint tenants with right of survivorship, as tenants by the entireties, as tenants in common, or by husband and wife as community property, shall be insured separately from accounts individually owned by any of the co-owners.

(b) Qualifying joint accounts. Joint accounts are insured separately from individual accounts up to a maximum of $100,000 provided that each of the co-owners has personally signed an account signature card and has a right of withdrawal on the same basis as the other co-owners.

(c) Failure to qualify. An account owned jointly which does not qualify as a joint account for purposes of insurance of accounts shall be treated as owned by the named persons as individuals and the actual ownership interest of each such person in such account shall be added to any other accounts individually owned by such person and insured up to $100,000 in the aggregate. An account will not fail to qualify as a joint account if a joint owner is a minor and applicable state law limits or restricts a minor's withdrawal rights.

(d) Same combination of individuals. All joint accounts owned by the same combination of individuals shall be added together and insured up to $100,000 in the aggregate.

(e) Different combination of individuals. A person holding an interest in more than one joint account owned by different combinations of individuals may receive a maximum of $100,000 insurance coverage on the total of his interest in those joint accounts.

(f) Nonmember joint owners. A nonmember may become a joint owner with a member on a joint account with right of survivorship. The nonmember's interest in such accounts will be insured in the same manner as the member joint-owner's interest.

§ 745.9–1 Trust Accounts.

(a) For purposes of this section, "trust" refers to an irrevocable trust.

(b) All trust interests (as defined in subsection 745.2(d)(4)), for the same beneficiary, deposited in an account and established pursuant to valid trust agreements created by the same settlor (grantor) shall be added together and insured up to $100,000 in the aggregate, separately from other accounts of the trustee of such trust funds or the settlor or beneficiary of such trust arrangements.

§ 745.9–2 IRA/Keogh Accounts.

(a) The present vested ascertainable interest of a participant or designated beneficiary in a trust or custodial account maintained pursuant to a pension or profit-sharing plan described under § 401(d) (Keogh account) or § 408(a) (IRA) of the Internal Revenue Code shall each be insured up to $100,000 separately from other accounts of the participant or designated beneficiary. An IRA account shall be separately insured from a Keogh account.

(b) Upon liquidation of the credit union, any share insurance payment shall be made by the NCUA Board to the trustee or custodian, or the successor trustee or custodian, unless otherwise directed in writing by the plan participant or beneficiary.

§ 745.9–3 Deferred Compensation Accounts.

Funds deposited by an employer pursuant to a deferred compensation plan (including § 401(K) of the Internal Revenue Code) shall be insured up to $100,000 as to the interest of each plan participant who is a member, separately from other accounts of the participant or employer.

§ 745.10 Public Unit Accounts.

(a) Public funds invested in Federal credit unions and federally-insured state credit unions authorized to accept such investments shall be insured as follows:

(1) Each official custodian of funds of the United States lawfully investing the same in a federally-insured credit union shall be separately insured up to $100,000;

(2) Each official custodian of funds of any state of the United States or any county, municipality, or political subdivision thereof lawfully investing the same in a federally-insured credit union in the same state shall be separately insured up to $100,000;

(3) Each official custodian of funds of the District of Columbia lawfully investing the same in a federally-insured credit union in the District of Columbia shall be separately insured up to $100,000;

(4) Each official custodian of funds of the Commonwealth of Puerto Rico, the Panama Canal Zone, or any territory or possession of the United States, or any county, municipality, or political subdivision thereof lawfully investing the same in a federally-insured credit union in Puerto Rico, the Panama Canal Zone, or any such territory or possession, respectively, shall be separately insured up to $100,000;

(5) Each official custodian of tribal funds of any Indian tribe (as defined in Section 3(c) of the Indian Financing Act of 1974) or agency thereof lawfully investing the same in a federally-insured credit union shall be separately insured up to $100,000.

(b) Each official custodian referred to in subsections (a) (2), (3), and (4) of this section lawfully investing such funds in a federally-insured credit union outside their respective jurisdictions shall be separately insured up to $100,000; and

(c) For purposes of this section, if the same person is an official custodian of more than one public unit, he shall be separately insured with respect to the public funds held by him for each such unit, but he shall not be separately insured with respect to all public funds of the same public unit by virtue of holding different offices in such unit or by holding such funds for different purposes.

(d) For purposes of this section, "lawfully investing" means pursuant to the statutory or regulatory authority of the custodian or public unit.

§ 745.11 Accounts Evidenced by Negotiable Instruments.

If any insured account obligation of a credit union is evidenced by a negotiable certificate account, negotiable draft, negotiable cashier's or officer's check, negotiable certified check, or negotiable traveler's check or letter of credit, the owner of such account obligation will be recognized for all purposes of a claim for insured accounts to the same extent as if his name and interest were disclosed on the records of the credit union provided the instrument was in fact negotiated to such owner prior to the date of the closing of the credit union. Affirmative proof of such negotiation must be offered in all cases to substantiate the claim.

§ 745.12 Account Obligations for Payment of Items Forwarded for Collection by Depository Institution Acting as Agent.

Where a closed credit union has become obligated for the payment of items forwarded for collection by a depository institution acting solely as agent, the owner of such items will be recognized for all purposes of a claim for insured accounts to the same extent as if his name and interest were disclosed on the records of the credit union when such claim for insured accounts, if otherwise payable, has been established by the execution and delivery of prescribed forms. Such depository institution forwarding such items for the owners thereof will be recognized as agent for such owners for the purpose of making an as-

signment of the rights of such owners against the closed insured credit union to the Board and for the purpose of receiving payment on behalf of such owners.

§ 745.13 Notification to Members/ Shareholders.

Each insured credit union shall provide notice to its members concerning NCUA insurance coverage of member accounts. This may be accomplished by placing either a copy of Part 745 of these rules, the Appendix, or one or more copies of the NCUA brochure "Your Insured Funds" in each branch office and main office of the credit union. Copies of these materials shall also be made available to members upon request. For purposes of this section, an automated teller machine or point of sale terminal is not a branch office.

APPENDIX—EXAMPLES OF INSURANCE COVERAGE AFFORDED ACCOUNTS IN CREDIT UNIONS INSURED BY THE NATIONAL CREDIT UNION INSURANCE FUND

The following examples illustrate insurance coverage on accounts maintained in the same federally-insured credit union. They are intended to cover various types of ownership interests and combinations of accounts which may occur in connection with funds invested in insured credit unions. These examples interpret the rules for insurance of accounts contained in 12 C.F.R. Part 745.

The examples, as well as the rules which they interpret, are predicated upon the assumption that, (1) invested funds are actually owned in the manner indicated on the credit union's records and (2) the owner of funds in an account is a credit union member or otherwise eligible to maintain an insured account in a credit union. If available evidence shows that ownership is different from that on the institution's records, the National Credit Union Share Insurance Fund may pay claims for insured accounts on the basis of actual rather than ostensible ownership. Further, the examples and the rules which they interpret do not extend insurance coverage to persons otherwise not entitled to maintain an insured account or to account relationships that have not been approved by the Board as an insured account.

7A. SINGLE OWNERSHIP ACCOUNTS

All funds owned by an individual member (or, in a community property state, by the husband-wife community of which the individual is a member) and invested in one or more individual accounts are added together and insured to the $100,000 maximum. This is true whether the accounts are maintained in the name of the individual member owning the funds, in the name of the member's agent or nominee, or in a custodial loan account on behalf of the member as a borrower. (§§ 745.3(a)(1), (2) and (3).) All such accounts are added together and insured as one individual account. Funds held in one or more accounts in the name of a guardian, custodian, or conservator for the benefit of a ward or minor are added together and insured up to $100,000. However, such account or accounts will not be added to any other individual accounts of the guardian, custodian, conservator, ward, or minor for purposes of determining insurance coverage. (§ 745.3(b).)

Example 1

Question: Members A and B, husband and wife, each maintain an individual account containing $100,000. In addition, they hold a joint account containing $100,000. What is the insurance coverage?

Answer: Each account is separately insured up to $100,000 for a total coverage of $300,000. The coverage would be the same whether the individual accounts contain funds owned as community property or as individual property of the spouses (§ 745.3(a)(1) and § 745.8(a)).

Example 2

Question: Members H and W, husband and wife, reside in a community property share. H maintains a $100,000 account consisting of his separately-owned funds and invests $100,000 of community property funds in another account, both of which are in his name alone. What is the insurance coverage?

Answer: The two accounts are added together and insured to a total of $100,000. $100,000 is uninsured (§ 745.3(a)(1)).

Example 3

Question: Member A has $92,500 invested in an individual account, and his agent, Member B, invests $25,000 of A's funds in a properly designated agency account. B also holds a $100,000 individual account. What is the insurance coverage?

Answer: A's individual account and the agency account are added together and insured to the $100,000 maximum, leaving $17,500 uninsured. The investment of funds through an agent does not result in additional insurance coverage for the principal (§ 745.3(a)(2)). B's individual account is insured separately from the agency account (§ 745.3(a)(1)). However, if the account records of the credit union do not show the agency relationship under which the funds in the $25,000 account are held, the $25,000 in B's name could, at the option of the NCUSIF, be added to his individual account and insured to $100,000 in the aggregate, leaving $25,000 uninsured (§ 745.2(c)).

Example 4

Question: Member A holds a $100,000 individual account. Member B holds two accounts in his own name, the first containing $25,000 and the second containing $92,500. In processing the claims for payment of insurance on these accounts, the NCUSIF discovers that the funds in the $25,000 account actually belong to A and that B had invested these funds as agent for A, his undisclosed principal. What is the insurance coverage?

Answer: Since the available evidence shows that A is the actual owner of the funds in the $25,000 account, those funds would be added to the $100,000 individual account held by A (rather than to B's $92,500 account) and insured to the $100,000 maximum, leaving $25,000 uninsured. (§ 745.3(a)(2).) B's $92,500 individual account would be separately insured.

Example 5

Question: Member C, a minor, maintains an individual account of $750. C's grandfather makes a gift to him of $100,000, which is invested in another account by C's father, designated on the credit union's records as custodian under a Uniform Gift to Minors Act. C's father, also a member, maintains an individual account of $100,000. What is the insurance coverage? Answer: C's individual account and the custodian account held for him by his father are each separately insured: the $100,000 maximum on the custodian account, and $750 on his individual account. The individual account held by C's father is also separately insured to the $100,000 maximum. (§§ 745.3(a)(1) and (b).)

Example 6

Question: Member G, a court-appointed guardian, invests in a properly designated account $100,000 of funds in his custody which belong to member W, his ward. W and G each maintain $25,000 individual accounts. What is the insurance coverage?

Answer: W's individual account and the guardianship account in G's name are each insured to $100,000 providing W with $125,000 in insured funds. G's individual account is also separately insured. (§§ 745.3(a)(1) and (b).)

Example 7

Question: X Credit Union acts as a servicer of FHA, VA, and conventional mortgage loans made to its members but sold to other parties. Each month X receives loan payments, for remittance to the other parties, from approximately 2,000 member mortgagors. The monies received each month total $1,000,000 and are maintained in a custodial loan account. What is the insurance coverage?

Answer: X Credit Union acts as custodian for the 2,000 individual mortgagors. The interest of each mortgagor is separately insured as his individual account (but added to any other individual accounts which the mortgagor holds in the Credit Union) (§ 745.3(a)(3)).

B. TESTAMENTARY ACCOUNTS

The term "testamentary account" refers to a revocable trust account, tentative or "Totten" trust account, "payable-on-death" account, or any similar account which evidences an intention that the funds shall pass on the death of the owner of the funds to a named beneficiary. If the beneficiary is a spouse, child, or grandchild of the owner, the funds in all such accounts are insured for the owner up to $100,000 in the aggregate as to each such beneficiary, separately from any other individual accounts of the owner. If the beneficiary of such an account is other than a spouse, child, or grandchild of the owner, the funds in the account are, for insurance purposes, added to any other individual accounts of the owner and insured up to $100,000 in the aggregate. In the case of a revocable trust account, the person who holds the power of revocation is deemed to be the owner of the funds in the account. If a revocable trust account is held in the name of a fiduciary other than the owner of the funds, any other accounts held by the fiduciary are insured separately from such revocable trust account.

Example 1

Question: Member H invests $200,000 in a revocable trust account with his son, S, and his daughter, D, as named beneficiaries. What is the insurance coverage?

Answer: Since S and D are children of H, the owner of the account, the funds are insured up to $100,000 as to each beneficiary (§ 745.4(b)). Assuming that S and D have equal beneficial inter-

ests ($100,000 each), H is fully insured for this account.

Example 2

Question: Member H invests $100,000 in each of four "payable-on-death" accounts. Under the terms of each account contract, H has the right to withdraw any or all of the funds in the account at any time. Any funds remaining in the account at the time of H's death are to be paid to a named beneficiary. The respective beneficiaries of the four accounts are H's wife, his mother, his brother, and his son. H also holds an individual account containing $100,000. What is the insurance coverage?

Answer: The accounts payable on death to H's wife and son are each separately insured to the $100,000 maximum (§ 745.4(b)). The accounts payable to H's mother and brother are added to H's individual account and insured to $100,000 in the aggregate, leaving $200,000 uninsured (§ 745.4(c)).

Example 3

Question: Members H and W jointly invest in a "payable-on-death" account for the benefit of their son, S, and daughter, D. The account is held by H and W with right of survivorship. What is the maximum insurance coverage available on the account? Answer: Since S and D are the children of H and W, the account will be insured up to $100,000 as to each beneficiary separately from any accounts of the owners, H and W (§ 745.4(b)). H would be entitled to $100,000 insurance for S and $100,000 for D. W would be entitled to the same coverage for a total of $400,000 on the account. However, upon the death of either H or W, insurance coverage would be reduced to $200,000.

C. ACCOUNTS HELD BY EXECUTORS OR ADMINISTRATORS

All funds belonging to a decedent and invested in one or more accounts, whether held in the name of the decedent or in the name of his executor or administrator, are added together and insured to the $100,000 maximum. Such funds are insured separately from the individual accounts of any of the beneficiaries of the estate or of the executor or administrator.

Example 1

Question: Member A, administrator of Member D's estate, sells D's automobile and invests the proceeds of $12,500 in an account entitled "A Administrator of the estate of D." A has an individual account in that same credit union containing $100,000. Prior to his death, D had opened an individual account of $100,000. What is the insurance coverage?

Answer: The $12,500 is added to D's individual account and insured to $100,000, leaving $12,500 uninsured. A's individual account is separately insured for $100,000 (§ 745.5).

D. ACCOUNTS HELD BY A CORPORATION, PARTNERSHIP OR UNINCORPORATED ASSOCIATION

All funds invested in an account or accounts by a corporation, a partnership or an unincorporated association engaged in any independent activity are added together and insured to the $100,000 maximum. The term "independent activity" means any activity other than the one directed solely at increasing coverage. If the corporation, partnership or unincorporated association is not engaged in an independent activity, any account held by the entity is insured as if owned by the persons owning or comprising the entity, and the imputed interest of each such person is added for insurance purposes to any individual account which he maintains.

Example 1

Question: Member X Corporation maintains a $100,000 account. The stock of the corporation is owned by members A, B, C, and D in equal shares. Each of these stockholders also maintains an individual account of $100,000 with the same credit union. What is the insurance coverage?

Answer: Each of the five accounts would be separately insured to $100,000 if the corporation is engaged in an independent activity and has not been established merely for the purpose of increasing insurance coverage. The same would be true if the business were operated as a bona fide partnership instead of as a corporation (§ 745.6). However, if X corporation was not engaged in an independent activity, then $25,000 (1/4 interest) would be added to each account of A, B, C, and D. The accounts of A, B, C, and D would then each be

insured to $100,000, leaving $25,000 in each account uninsured.

Example 2

Question: Member C College maintains three separate accounts with the same credit union under the titles: "General Operating Fund," "Teachers Salaries," and "Building Fund." What is the insurance coverage?

Answer: Since all of the funds are the property of the college, the three accounts are added together and insured only to the $100,000 maximum (§ 745.6).

Example 3

Question: The men's club of X Church carries on various social activities in addition to holding several fund-raising campaigns for the church each year. The club is supported by membership dues. Both the club and X Church maintain member accounts in the same credit union. What is the insurance coverage?

Answer: The men's club is an unincorporated association engaged in an independent activity. If the club funds are, in fact, legally owned by the club itself and not the church, each account is separately insured to the $100,000 maximum (§ 745.6).

Example 4

Question: The PQR Union, a member of the ABC Federal Credit Union, has three locals in a certain city. Each of the locals maintains an account containing funds belonging to the parent organization. All three accounts are in the same insured credit union. What is the insurance coverage?

Answer: The three accounts are added together and insured up to the $100,000 maximum (§ 745.6).

E. PUBLIC UNIT ACCOUNTS

For insurance purposes, the official custodian of funds belonging to a public unit, rather than the public unit itself, is insured as the accountholder. All funds belonging to a public unit and invested by the same custodian in an insured credit union are added together and insured to the $100,000 maximum, regardless of the number of accounts involved and regardless of whether the funds are invested in accounts located in or outside the state. If there is more than one official custodian for the same public unit, the funds invested by each custodian are separately insured up to $100,000. If the same person is custodian of funds for more than one public unit, he is separately insured to $100,000 with respect to the funds of each unit held by him in properly designated accounts. The maximum coverage for an official custodian of funds of the United States would be $100,000.

For insurance purposes, a "political subdivision" is entitled to the same insurance coverage as any other public units. "Political subdivision" includes any subdivision of a public unit or any principal department of such unit (1) the creation of which has been expressly authorized by state statute, (2) to which some functions of government have been allocated by state statute, and (3) to which funds have been allocated by statute or ordinance for its exclusive use and control.

Example 1

Question: As Comptroller of Y Consolidated School District, A maintains a $125,000 account in the credit union containing school district funds. He also maintains his own $100,000 member account in the same credit union. What is the insurance coverage? Answer: The two accounts will be separately insured, assuming the credit union's records indicate that the account containing the school district funds is held by A in a fiduciary capacity. Thus, $100,000 of the school's funds and the entire $100,000 in A's personal account will be insured (§§ 745.10(a)(2) and 745.3).

Example 2

Question: A, as city treasurer, and B, as chief of the city police department, each have $100,000 in city funds invested in custodial accounts. What is the insurance coverage?

Answer: Assuming that both A and B have official custody of the city funds, each account is separately insured to the $100,000 maximum (§ 745.10(a)(2)).

Example 3

Question: A is Treasurer of X County and collects certain tax assessments, a portion of which must be paid to the state under statutory requirement. A maintains an account for general funds

which belong to the State Treasurer. The credit union's records indicate that the separate account contains funds held for the State. What is the insurance coverage?

Answer: Since two public units own the funds held by A, the accounts would each be separately insured to the $100,000 maximum (§ 745.10(a)(2)).

Example 4

Question: A city treasurer invests city funds in each of the following accounts: "General Operating Account," "School Transportation Fund," "Local Maintenance Fund," and "Payroll Fund." By administrative direction the city treasurer has allocated the funds for the use of and control by separate departments of the city. What is the insurance coverage?

Answer: All of the accounts are added together and insured in the aggregate to $100,000. Because the allocation of the city's funds is not by statute or ordinance for the specific use of and control by separate departments of the city, separate insurance coverage to the maximum of $100,000 is not afforded to each account (§§ 745.1(d) and 745.10(a)(2)).

Example 5

Question: A, the custodian of retirement funds of a military exchange, invests $1,000,000 in an insured credit union. The military exchange, a nonappropriated fund instrumentally of the United States, is deemed to be a public unit. The employees of the exchange are the beneficiaries of the retirement funds but are not members of the credit union. What is the insurance coverage?

Answer: Because A invested the funds on behalf of a public unit, in his capacity as custodian, those funds qualify for $100,000 share insurance even though A and the public unit are not within the credit union's field of membership. Since the beneficiaries are neither public units nor members of the credit union they are not entitled to separate share insurance. Therefore, $900,000 is uninsured (§ 745.10(a)(1)).

Example 6

Question: A is the custodian of the County's employee retirement funds. He deposits $1,000,000 in retirement funds with the credit union. The "beneficiaries" of the retirement fund are not themselves public units nor are they within the credit union's field of membership. What is the insurance coverage?

Answer: Because A invested the funds on behalf of a public unit, in his capacity as custodian, those funds qualify for $100,000 share insurance even though A and the public unit are not within the credit union's field of membership. Since the beneficiaries are neither public units nor members of the credit union they are not entitled to separate share insurance. Therefore, $900,000 is uninsured (§ 745.10(a)(2)).

Example 7

Question: A county treasurer deposits in an insured credit union $100,000 in each of the following accounts:

"General Operating Fund"
"County Roads Department Fund"
"County Water District Fund"
"County Public Improvement District Fund"
"County Emergency Fund"

What is the insurance coverage?

Answer: The "County Roads Department," "County Water District" and "County Public Improvement District" accounts would each be separately insured to $100,000 if the funds in each such account have been allocated by law for the exclusive use of a separate county department of subdivision expressly authorized by State statute.

Funds in the "General Operating" and "Emergency Fund" accounts would be added together and insured in the aggregate to $100,000, if such funds are for countywide use and not for the exclusive use of any subdivision or principal department of the county, expressly authorized by State statute (§§ 745.1(d) and 745.10(a)(2)).

Example 8

Question: A, the custodian of Indian tribal funds, lawfully invests $1,000,000 in an account in an insured credit union on behalf of 15 different tribes; the records of the credit union show that no tribe's interest exceeds $100,000. A, as official custodian, also invests $1,000,000 in the same credit union on behalf of 100 individual indians, who are not members; each indian's interest is $10,000. What is the insurance coverage?

Answer: Because each tribe is considered a separate public unit, the custodian of each tribe, even though the same person, is entitled to separate insurance for each tribe (§ 745.10(a)(5)). Since the credit union's records indicate no tribe has more

than $100,000 in the account, the $1,000,000 would be fully insured as 15 separate tribal accounts. If any one tribe had more than a $100,000 interest in the funds, it would be insured only to $100,000 and any excess would be uninsured. However, the $1,000,000 invested on behalf of the individual indians would not be insured since the individual indians are neither public units nor, in the example, members of the credit union. If A is the custodian of the funds in his capacity as an official of a governmental body that qualified as a public unit, then the account would be insured for $100,000 leaving $900,000 uninsured.

F. JOINT ACCOUNTS

Accounts held under any form of joint ownership valid under state law (whether as joint tenants with right of survivorship, tenants by the entireties, tenants in common, or by husband and wife as community property) are insured up to $100,000. This insurance is separate from that afforded individual accounts held by any of the co-owners.

An account is insured as a joint account only if each of the co-owners has personally executed an account signature card and possesses withdrawal rights. An account owned jointly which does not qualify as a joint account for insurance purposes is insured as if owned by the named persons as individuals. In that case, the actual ownership interest in the account of each person is added to any other accounts individually owned by such person and insured up to $100,000 in the aggregate.

Any individual, including a minor, may be a co-owner of a joint account. Although, generally, each co-owner must have signed an account signature card and must have the same rights of withdrawal as other co-owners in order for the account to qualify for separate joint account insurance, there is an exception. If state law limits or restricts a minor's withdrawal rights—for example, a minimum age requirement to make a withdrawal—the account will still be insured as a joint account.

All funds invested in joint accounts owned by the same combination of individuals are first added together and insured to the $100,000 maximum. Where a member has an interest in more than one joint account and different joint owners are involved, his interests in all of such joint accounts are then added together and insured to $100,000 in the aggregate.

For insurance purposes, the co-owners of any joint account are deemed to have equal interests in the account, except in the case of a tenancy in common. With a tenancy in common, equal interests are presumed unless otherwise stated on the records of the credit union.

Example 1

Question: Members A and B maintain an account as joint tenants with right of survivorship and, in addition, each holds an individual account. Is each account separately insured?

Answer: If both A and B have executed the signature card and possess withdrawal rights with respect to the joint funds, each account is separately insured to the $100,000 maximum (§ 745.8 (a) and (b)).

Example 2

Question: Members H and W, husband and wife, reside in a community property state. Each holds an individual account and, in addition, they hold a qualifying joint account. The funds in all three accounts consist of community property. Is each account separately insured?

Answer: Yes. An account in the individual name of a spouse will be insured up to $100,000 whether the funds consist of community property or separate property of the spouse. A joint account containing community property is also insured up to $100,000. Thus, community property can be used for individual accounts in the name of each spouse and for a joint account in the name of both spouses, each of which accounts is separately insured up to $100,000 (§§ 745.3(a)(1) and 745.8(a)).

Example 3

Question: Two accounts of $100,000 each are held by a member husband and wife under the following names:

John Doe and Mary Doe, husband and wife, as joint tenants with right of survivorship.

Mrs. John Doe and John Q. Doe (community property).

Are the accounts separately insured?

Answer: No. Both accounts are considered joint accounts owned by the same combination of individuals, regardless of the form of joint ownership. Reversal of names or use of different styles does

not change the result, as long as the account owners are in fact the same in both cases. For insurance purposes, the accounts are added together and insured to the maximum of $100,000, leaving $100,000 uninsured (§ 745.8(d)).

Example 4

Question: The following accounts are held by members A, B and C, each of whom has personally executed signature cards for the accounts in which he has an interest. Each co-owner of a joint account possesses the necessary withdrawal rights.

1. A, as an individual—$100,000
2. B, as an individual—$100,000
3. C, as an individual—$100,000
4. A and B, as joint tenants w/r/o survivorship—$90,000
5. A and C, as joint tenants w/r/o survivorship—$90,000
6. B and C, as joint tenants w/r/o survivorship—$90,000
7. A, B and C, as joint tenants w/r/o survivorship—$90,000

What is the insurance coverage?

Answer: Accounts numbers 1, 2 and 3 are each separately insured for $100,000 as individual accounts held by A, B and C, respectively (§ 745.3(a)(1)). With regard to accounts numbered 4, 5, 6 and 7, the respective interests of A, B and C in such accounts are added together for insurance purposes (§ 745.8(e)). The interest of the co-owners of each joint account are deemed equal for insurance purposes (§ 745.2(c)(4)). Thus, A has an interest of $45,000 in account No. 4, $45,000 in account No. 5 and $30,000 in account No. 7, for a total joint account interest of $120,000, of which $100,000 is insured. The interests of B and C are similarly insured.

Example 5(a)

Question: A, B and C hold accounts as set forth in Example 4. Members A and B are husband and wife; C, their minor child, has failed to sign the signature card for Account No. 7. In Account No. 5, according to the terms of the account, C cannot make a withdrawal without A's written consent. (This is not a limitation imposed under state law.) In Account No. 6, the signatures of both B and C are required for withdrawal. A has provided all of the funds for Accounts numbered 5 and 7 and under state law has the entire actual ownership interest in these two accounts. What is the insurance coverage?

Answer: If any of the co-owners of a joint account have failed to meet any of the joint account requirements, the account is not insured as a joint account. Instead, the account is insured as if it consisted of commingled individual accounts of each of the co-owners in accordance with his actual ownership interest in the funds, as determined under applicable state law. (§ 745.8(c).)

Account No. 5 is not insured as a joint account because C does not have equal withdrawal rights with A. Based on the terms of the account, C can only make a withdrawal if he has A's written consent. Account No. 7 is not insured as a joint account because C did not personally sign the signature card. Therefore, all of the funds in Accounts 5 and 7 are treated as individually owned by A and added to A's individual account, Account No. 1. For insurance purposes then, A has $280,000 in one individual account that is insured for $100,000, leaving $180,000 uninsured.

Account 6 does qualify as a joint account for insurance purposes since each co-owner has the right to withdraw funds on the same basis. Account 4, the remaining joint account, and Account 6 are each insured to the $100,000 limit since they are owned by different combinations of individuals and no co-owner has an aggregate interest in the two accounts in excess of $100,000.

Example 5(b)

Question: Assume the same accounts as Example 5(a) except that, on Account No. 5, C's right to make a withdrawal is limited by state law which precludes a minor from making a withdrawal without the co-owner's written consent. What is the insurance coverage?

Answer: In this situation, Accounts 4, 5, and 6 all qualify as joint accounts and would be fully insured since no co-owner has an aggregate interest in the accounts of more than $100,000. A, B, and C will each have $90,000 of insured funds based on: A's interest in Accounts 4 ($45,000) and 5 ($45,000), B's interest in Accounts 4 ($45,000) and 6 ($45,000), and C's interest in Accounts 5 ($45,000) and 6 ($45,000). As in Example 5(a), Account No. 7 does not qualify as a joint account and would be added to A's individual account for insurance purposes.

Example 6

Question: The following accounts are owned by members, A, B and C, each of whom has personally executed signature cards for the accounts in which he has an interest. Each co-owner possesses withdrawal rights.

1. A, as an individual—$100,000
2. B, as an individual—$100,000
3. A, B and C, as joint tenants w/r/o survivorship—$100,000
4. A, B and C, as joint tenants w/r/o survivorship—$200,000
5. A, and B, as joint tenants w/r/o survivorship—$100,000

What is the insurance coverage?

Answer: Accounts numbers 1 and 2 are each separately insured for $100,000 as individual accounts held by A, B, respectively (§ 745.3(a)(1)). With respect to the joint accounts, accounts numbered 3 and 4 are owned by the same combination of individuals and are added together and insured to a maximum of $100,000, leaving $200,000 uninsured (§ 745.8(d)). A, B and C each have a $33,334 insured interest in accounts 3 and 4. A and B also maintain a joint account, account number 5. Because C has no interest in this account, it is owned by a combination of individuals different from accounts 3 and 4. The interests of A and B in account number 5 are deemed to be equal (§ 745.2(c)(4)). A's $50,000 interest in account 5 is added to his insured interest in accounts 3 and 4, giving him a total of $83,334 insurance coverage for his interests in the various joint accounts, in addition to the insurance in the amount of $100,000 provided for his individual account. B's interests in accounts 3, 4 and 5 are identical to A's and her interests are insured in a like manner.

G. TRUST ACCOUNTS AND RETIREMENT ACCOUNTS

A trust estate is the interest of a beneficiary in an irrevocable express trust, whether created by trust instrument or statute, that is valid under state law. Thus, funds invested in an account by a trustee under an irrevocable express trust are insured on the basis of the beneficial interests under such trust. The interest of each beneficiary in an account (or accounts) established under such a trust arrangement is insured to $100,000 separately from other accounts held by the trustee, the settlor (grantor), or the beneficiary. However, in cases where a beneficiary has an interest in more than one trust arrangement created by the same settlor, the interests of the beneficiary in all accounts established under such trusts are added together for insurance purposes, and the beneficiary's aggregate interest derived from the same settlor is separately insured to the $100,000 maximum.

A beneficiary's interest in an account established pursuant to an irrevocable express trust arrangement is insured separately from other beneficial interests (trust estates) invested in the same account if the value of the beneficiary's interest (trust estate) can be determined (as of the date of a credit union's insolvency) without evaluation of contingencies except for those covered by the present worth tables and rules of calculation for their use set forth in § 20.2031–10 of the Federal Estate Tax Regulations (26 C.F.R. 20–2031–10). If any trust estates in such an account cannot be so determined, the insurance with respect to all such trust estates together shall not exceed the basic insured amount of $100,000.

In order for insurance coverage of trust accounts to be effective in accordance with the foregoing rules, certain recordkeeping requirements must be met. In connection with each trust account, the credit union's records must indicate the name of both the settlor and the trustee of the trust and must contain an account signature card executed by the trustee indicating the fiduciary capacity of the trustee. In addition, the interests of the beneficiaries under the trust must be ascertainable from the records of either the credit union or the trustee, and the settlor or beneficiary must be a member of the credit union. If there are two or more settlors or beneficiaries, then either all the settlors or all the beneficiaries must be members of the credit union.

Although each ascertainable trust estate is separately insured, it should be noted that in short-term trusts the insurable interest or interests may be very small, since the interests are computed only for the duration of the trust. Thus, if a trust is made irrevocable for a specified period of time, the beneficial interest will be calculated in terms of the length of time stated. A reversionary interest retained by the settlor is treated in the same manner as an individual account of the settlor.

As stated, the trust must be valid under local law. A trust which does not meet local requirements, such as one imposing no duties on the trustee or conveying no interest to the beneficiary, is of no effect for insurance purposes. An account in which such funds are invested is considered to be an individual account.

An account established pursuant to a revocable trust arrangement is insured as a form of individual account and is treated under Section B, supra, dealing with Testamentary Accounts.

IRA and Keogh accounts are separately insured, each up to $100,000. Although credit unions may serve as trustees or custodians for self-directed IRA and Keogh accounts, once the funds are taken out of the credit union, they are no longer insured.

In the case of an employee retirement fund where only a portion of the fund is placed in a credit union account, the amount of insurance available to an individual member/beneficiary on his interest in the account will be in proportion to his interest in the entire employee retirement fund. If, for example, the member's interest represents 10% of the entire plan funds, then he is presumed to have only a 10% interest in the plan account. Said another way, if a member has a vested interest of $10,000 in a municipal employees retirement plan and the trustee invests 25% of the total plan funds in a credit union, the member would be insured for only $2,500 on that credit union account. There is an exception, however. The member would be insured for $10,000 if the trustee can document, through records maintained in the ordinary course of business, that individual beneficiary's interests are segregated and the total vested interest of the member was, in fact, invested in that account.

Example 1

Question: Member S invests $45,000 in trust for B, the beneficiary. S also has an individual account containing $90,000 in the same credit union. What is the insurance coverage?

Answer: Both accounts are fully insured. The trust account is separately insured from the individual account of S (§§ 745.3(a)(1) and 745.9–1).

Example 2

Question: S invests funds in trust for A, B, C, D, and E. A, B, and C are members of the credit union, D, E, and S are not. What is the insurance coverage?

Answer: This is an uninsurable account. Where there is more than one settlor or more than one beneficiary, all the settlors or all the beneficiaries must be members to establish this type of account. Since D, E and S are not members, this account cannot legally be established or insured.

Example 3

Question: Member S invests $500,000 in trust for ABC Employees Retirement Fund. Some of the beneficiaries are members and some are not. What is the insurance coverage?

Answer: The account is insured as to the determinable interests of each member beneficiary to a maximum of $100,000 per member. Member interests not capable of evaluation and nonmember interests shall be added together and insured to a maximum of $100,000 in the aggregate (§ 745.9–1).

Example 3(a)

Question: Member S is trustee for the ABC Employees Retirement Fund containing $1,000,000. Member A has a determinable interest of $90,000 in the Fund (9% of the total). S invests $500,000 of the Fund in trust in an insured credit union and the remaining $500,000 elsewhere. Some of the beneficiaries of the Fund are members of the credit union and some are not. S does not segregate each employee's interest in the Fund. What is the insurance coverage?

Answer: The account is insured as to determinable interest of each member beneficiary, adjusted in proportion to the Fund's investment in the credit union. A's insured interest in the account is $45,000, or 9% of $500,000. This reflects the fact that only 50% of the Fund is in the account and A's interest in the account is in the same proportion as his interest in the overall plan. Each beneficiary who is a member would be similarly insured. Members' interests not capable of evaluation and nonmembers' interests are added together and insured to a maximum of $100,000 in the aggregate (§ 745.9–1).

Example 4

Question: Member A has an individual account of $100,000 and establishes an IRA and accumulates $50,000 in that account. Subsequently A becomes self-employed and establishes a Keogh account in the same credit union and accumulates $100,000 in that account. What is the insurance coverage?

Answer: Each of A's accounts would be separately insured for up to $100,000. In the example, A would be fully insured for $250,000 (§§ 745.3(a)(1) and 745.9–2).

Example 5

Question: Member A has a self-directed IRA account with $70,000 in it. The FCU is the trustee of the account. Member transfers $40,000 into a blue chip stock; $30,000 remains in the FCU. What is the insurance coverage?

Answer: Originally, the full $70,000 in A's IRA account is insured. The $40,000 is no longer insured once it is moved out of the FCU. The $30,000 remaining in the FCU is insured (§ 745.9–2).

Subpart B—Payment of Share Insurance and Appeals

§ 745.200 General.

(a) *Payment.* In the event of the liquidation of an insured credit union, the Board will promptly determine the insured accountholders thereof and the amount of the insured account or accounts of each such accountholder. Payment may be in cash, or its equivalent, or may be made by making available to each accountholder a transferred account in a new federally-insured credit union in the same community or in another federally-insured credit union or institution in an amount equal to the accountholder's insured account. Notwithstanding the foregoing, the Board may withhold payment of such portion of the insured account of any member as may be required to provide for payment of any direct or indirect liability to the closed credit union or the liquidating agent, which is not offset against a claim due from such credit union, pending the determination and payment of such liability by the member or any person liable therefor.

(b) *Amount of insurance.* The amount of insurance on an insured account shall be determined in accordance with the provisions of Subpart A of this part and the Federal Credit Union Act. For the purpose of determining insurance coverage, dividends earned in the ordinary course of business and posted to share accounts for any prior accounting or dividend period shall be deemed to be principal under this part. Dividends earned or accrued in the ordinary course of business, but not posted to share accounts, may be paid at the discretion of the liquidating agent. In making such determination, the liquidating agent will take into consideration whether the failure to post dividends earned or accrued was due to the fraud, embezzlement or accounting errors of credit union personnel. The liquidating agent may require an accountholder to submit documentation supporting any claim for unposted dividends not otherwise evidenced in the credit union records. However, in no event will dividend amounts be considered as principal for insurance purposes pursuant to this section if not consistent with the amounts paid on similar classes of shares.

(c) *Multiple accounts.* In the event an insured member holds more than one insured account in the same capacity, and the aggregate amount of such accounts (including share draft accounts held in such capacity) exceeds the amount of insurance afforded thereon, the insurance coverage will be prorated among the member's interest in all accounts held in the same capacity. In the case of individual accounts, the insurance proceeds shall be paid to the holder of the account, whether or not the holder is the beneficial owner. In the case of accounts which are owned jointly, the insurance proceeds shall be paid to the owners jointly. In the case of trust estates, the insurance proceeds shall be paid to the indicated trustee unless otherwise provided for in the trust instrument or under state law. In the case of corporations, partnerships and unincorporated associations engaged in an independent activity, the insurance proceeds shall be paid to the indicated holder of the account. Where insurance payment is in the form of a transferred account to another insured institution, the same rules shall be applied.

(d) *Computing time.* In computing any period of time prescribed by this subpart, the provisions of § 747.12(a) shall apply.

§ 745.201 Processing of Insurance Claims.

(a) *Delegations of authority.* The Agent for the Liquidating Agent ("Liquidating Agent") or his or her designee is authorized to make initial determinations with respect to insurance claims pursuant to the principles set forth in this Part, and to act on requests for reconsideration of the initial determination.

(b) *Initial determination.* In the event the Liquidating Agent determines that all or a portion of an accountholder's account is uninsured, the Liquidating Agent shall so notify the accountholder in writing, stating the reason(s) for such initial determination, and shall provide the accountholder with a certificate of claim in liquidation in the amount of the uninsured account from the Board in its capacity as Liquidating Agent for the insured credit union to enable the accountholder to share in the proceeds of the liquidation of the credit union, if any, up to the amount of the uninsured account.

(c) *Request for Reconsideration.* An accountholder may, at his or her option, request reconsideration from the Liquidating Agent of the initial determination within 30 days of the date of the initial determination, or directly appeal the initial determination to the Board pursuant to § 745.202 of this subpart. The Liquidating Agent shall act on the request for reconsideration within 30 days from its receipt.

§ 745.202 Appeal.

(a) *Time for filing.* Within 60 days after issuance of an initial determination, or of the determination on a request for reconsideration by the liquidating agent, the accountholder may appeal by filing with the Board a written request for appeal. The appeal may be filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

(b) *Content of request.* Any appeal must include:

(1) a statement of the facts on which the claim for insurance is based;

(2) a statement of the basis for the initial determination or determination on the request for reconsideration to which the accountholder objects and the alleged error in such determination, including citations to applicable statutes and regulations;

(3) any other evidence relied upon by the accountholder which was not previously provided to the Liquidating Agent.

(c) *Procedures for review of request.*

(1) Within 60 days of the date of the Board's receipt of an appeal, the Board may request in writing that the accountholder submit additional facts and records in support of its request. The account-holder shall have 45 days from the date of issuance of such written request to provide such additional information. Failure by the accountholder to provide additional information may, as determined solely by the Board, result in denial of the account-holder's appeal.

(2) Within 60 days from the date of the Board's receipt of an appeal, the accountholder may amend or supplement the request in writing. In the event that the accountholder does amend or supplement the request, the provisions of paragraph (c)(1) of this section with respect to requests for additional information and responses to such requests shall apply with equal force to any such amendment or supplement to a request.

(d) *Determination on appeal.*

(1) Within 180 days from the date of the receipt of an appeal by the Board, the Board shall issue a decision determining the extent of the accountholder's insurance pursuant to the rules of this Part.

(2) The determination by the Board on appeal shall be provided to the accountholder in writing, stating the reason(s) for the determination, and shall constitute a final Agency order regarding the accountholder's claim for insurance.

(3) If the Board determines that the account-holder is entitled to the amount of insurance claimed or portion thereof, upon payment of such insurance the accountholder shall promptly surrender to the Board the certificate of claim in liquidation provided in connection with the initial determination. In the event that the Board determines that the accountholder is only entitled to a portion of the amount of insurance claimed, upon the accountholder's surrender of such certificate a new certificate of claim in liquidation will be provided which reflects the revised amount of the uninsured account.

(4) Failure by the Board to issue a determination on appeal of the accountholder's claim for insurance within the 180-day period provided for under this paragraph (d)(1) shall be deemed to be a denial of such claim for purposes of Section 745.203 of this subpart.

§ 745.203 Judicial Review.

(a) For purposes of seeking judicial review of actions taken pursuant to this subpart, only a determination on appeal issued by the Board pursuant to Section 745.202 of this subpart shall constitute a final determination regarding an accountholder's claim for insurance.

(b) Failure to file an appeal with regard to an initial determination, or a decision rendered on a request for reconsideration within the applicable time periods shall constitute a failure by the accountholder to exhaust available administrative remedies and, due to such failure, any objections to the initial determination or request for reconsideration shall be deemed to be waived and such determination shall be deemed to have been accepted by, and binding upon, the accountholder.

(c) Final determination by the Board is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States Court of Appeals for the District of Columbia or the court of appeals for the Federal judicial circuit where the credit union's principal place of business is located. Such action must be filed not later than 60 days after such final determination is ordered.

Part 747

Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations

§ 747.0 Scope.

(a) This Part describes the various formal and informal adjudicative actions and non-adjudicative proceedings available to the National Credit Union Administration Board ("NCUA Board"), the grounds for those actions and proceedings, and the procedures used in formal and informal hearings related to each available action. As mandated by Section 916 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") (12 U.S.C. § 1818 note), this Part incorporates uniform rules of practice and procedure governing formal adjudications generally, as well as proceedings involving cease-and-desist actions, assessment of civil money penalties, and removal, prohibition and suspension actions. In addition, the Uniform Rules are incorporated in other subparts of this Part which provide for formal adjudications. The administrative actions and proceedings described herein, as well as the grounds and hearing procedures for each, are controlled by Sections 120(b) (except where the Federal credit union is closed due to insolvency), 202(a)(3) and 206 of the Act (12 U.S.C. §§ 1766(b), 1782(a)(3), 1786). Should any provision of this Part be inconsistent with these or any other provisions of the Act, as amended, the Act shall control. Judicial enforcement of any action or order described in this Part, as well as judicial review thereof, shall be as prescribed under the Act (12 U.S.C. § 1751 *et seq.*) and the Administrative Procedure Act (5 U.S.C. § 500 *et seq.*).

(b) As used in this Part, the term insured credit union means any Federal credit union or any state-chartered credit union insured under Subchapter II of the Act unless the context indicates otherwise.

Subpart A—Uniform Rules of Practice and Procedure

§ 747.1 Scope.

This Subpart prescribes uniform rules of practice and procedure applicable to adjudicatory proceedings required to be conducted on the record after opportunity for a hearing under the following statutory provisions:

(a) Cease-and-desist proceedings under Section 206(e) of the Act (12 U.S.C. 1786(e));

(b) Removal and prohibition proceedings under Section 206(g) of the Act (12 U.S.C. 1786(g));

(c) Assessment of civil money penalties by the NCUA Board against institutions and institution-affiliated parties for any violation of:

(1) Section 202 of the Act, pursuant to 12 U.S.C. 1782(a);

(2) Section 1120 of FIRREA (12 U.S.C. 3349), or any order or regulation issued thereunder;

(3) The terms of any final or temporary order issued under section 206 of the Act or any written agreement executed by the National Credit Union Administration ("NCUA"), any condition imposed in writing by the NCUA in connection with the grant of an application or request, certain unsafe or unsound practices or breaches of fiduciary duty, or any law or regulation not otherwise provided herein, pursuant to 12 U.S.C. 1786(k); and

(4) Any provision of law referenced in section 102(f) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(f)) or any order or regulation issued thereunder;

(d) Remedial action under section 102(g) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a(g)); and

(e) This subpart also applies to all other adjudications required by statute to be determined on the record after opportunity for an agency hearing, unless otherwise specifically provided for in Subparts B through J of this Part.

§ 747.2 Rules of Construction.

For purposes of this Subpart:

(a) Any term in the singular includes the plural, and the plural includes the singular, if such use would be appropriate;

(b) Any use of a masculine, feminine, or neuter gender encompasses all three, if such use would be appropriate;

(c) The term *counsel* includes a non-attorney representative; and

(d) Unless the context requires otherwise, a party's counsel of record, if any, may, on behalf of that party, take any action required to be taken by the party.

§ 747.3 Definitions.

For purposes of this Subpart, unless explicitly stated to the contrary:

(a) *Administrative law judge* means one who presides at an administrative hearing under authority set forth at 5 U.S.C. 556.

(b) *Adjudicatory proceeding* means a proceeding conducted pursuant to these rules and leading to the formulation of a final order other than a regulation.

(c) *Decisional employee* means any member of the NCUA's or administrative law judge's staff who has not engaged in an investigative or prosecutorial role in a proceeding and who may assist the Agency or the administrative law judge, respectively, in preparing orders, recommended decisions, decisions, and other documents under the Uniform Rules.

(d) *Enforcement Counsel* means any individual who files a notice of appearance as counsel on behalf of the NCUA in an adjudicatory proceeding.

(e) *Final order* means an order issued by the NCUA with or without the consent of the affected institution or the institution-affiliated party, that has become final, without regard to the pendency of any petition for reconsideration or review.

(f) *Institution* includes:

(1) Any Federal credit union as that term is defined in Section 101(1) of the Act (12 U.S.C. 1752(1)); and

(2) Any insured state credit union as that term is defined in Section 101(7) of the Act (12 U.S.C. 1752(7)).

(g) *Institution-affiliated party* means any institution-affiliated party as that term is defined in Section 206(r) of the Act (12 U.S.C. 1786(r)).

(h) *Local rules* means those rules promulgated by the NCUA in the Subparts of this Part other than Subpart A of this Part.

(i) *OFIA* means the Office of Financial Institution Adjudication, which is the executive body charged with overseeing the administration of administrative enforcement proceedings for the NCUA, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS).

(j) *Party* means the NCUA and any person named as a party in any notice.

(k) *Person* means an individual, sole proprietor, partnership, corporation, unincorporated association, trust, joint venture, pool, syndicate, agency, or other entity or organization, including an institution as defined in paragraph (f) of this section.

(l) *Respondent* means any party other than the NCUA.

(m) *Uniform Rules* means those rules in Subpart A of this Part that are common to the NCUA, the OCC, the Board, the FDIC, and the OTS.

(n) *Violation* includes any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

§ 747.4 Authority of the NCUA Board.

The NCUA Board may, at any time during the pendency of a proceeding, perform, direct the performance of, or waive performance of, any act which could be done or ordered by the administrative law judge.

§ 747.5 Authority of the Administrative Law Judge.

(a) *General rule.* All proceedings governed by this Part shall be conducted in accordance with the provisions of Chapter 5 of Title 5 of the United States Code. The administrative law judge shall have all powers necessary to conduct a proceeding in a fair and impartial manner and to avoid unnecessary delay.

(b) *Powers.* The administrative law judge shall have all powers necessary to conduct the proceeding in accordance with paragraph (a) of this Section, including the following powers:

(1) To administer oaths and affirmations;

(2) To issue subpoenas, subpoenas duces tecum, and protective orders, as authorized by this Part, and to quash or modify any such subpoenas and orders;

(3) To receive relevant evidence and to rule upon the admission of evidence and offers of proof;

(4) To take or cause depositions to be taken as authorized by this Subpart;

(5) To regulate the course of the hearing and the conduct of the parties and their counsel;

(6) To hold scheduling and/or pre-hearing conferences as set forth in § 747.31;

(7) To consider and rule upon all procedural and other motions appropriate in an adjudicatory proceeding, provided that only the NCUA Board shall have the power to grant any motion to dismiss the proceeding or to decide any other motion that results in a final determination of the merits of the proceeding;

(8) To prepare and present to the NCUA Board a recommended decision as provided herein;

(9) To recuse himself or herself by motion made by a party or on his or her own motion;

(10) To establish time, place and manner limitations on the attendance of the public and the media for any public hearing; and

(11) To do all other things necessary and appropriate to discharge the duties of a presiding officer.

§ 747.6 Appearance and Practice in Adjudicatory Proceedings.

(a) *Appearance before the NCUA or an administrative law judge.* (1) *By attorneys.* Any member in good standing of the bar of the highest court of any state, commonwealth, possession, territory of the United States, or the District of Columbia may represent others before the NCUA if such attorney is not currently suspended or debarred from practice before the NCUA.

(2) *By non-attorneys.* An individual may appear on his or her own behalf; a member of a partnership may represent the partnership; a duly authorized officer, director, or employee of any government unit, agency, institution, corporation, or authority may represent that unit, agency, institution, corporation, or authority if such officer, director, or employee is not currently suspended or debarred from practice before the NCUA.

(3) *Notice of appearance.* Any individual acting as counsel on behalf of a party, including the NCUA Board, shall file a notice of appearance with OFIA at or before the time that the individual submits papers or otherwise appears on behalf of a party in the adjudicatory proceeding. The notice of appearance must include a written declaration that the individual is currently qualified as provided in paragraph (a)(1) or (a)(2) of this section and is authorized to represent the particular party. By filing a notice of appearance on behalf of a party in an adjudicatory proceeding, the counsel agrees and represents that he or she is authorized to accept service on behalf of the represented party and that, in the event of withdrawal from representation, he or she will, if required by the administrative law judge, continue to accept service until new counsel has filed a notice of appearance or until the represented party indicates that he or she will proceed on a *pro se* basis.

(b) *Sanctions.* Dilatory, obstructionist, egregious, contemptuous, or contumacious conduct at any phase of any adjudicatory proceeding may be grounds for exclusion or suspension of counsel from the proceeding.

§ 747.7 Good Faith Certification.

(a) *General requirement.* Every filing or submission of record following the issuance of a notice shall be signed by at least one counsel of record in his or her individual name and shall state that counsel's address and telephone number. A party who acts as his or her own counsel shall sign his or her individual name and state his or her address and telephone number on every filing or submission of record.

(b) *Effect of signature.* (1) The signature of counsel or a party shall constitute a certification that: the counsel or party has read the filing or submission of record; to the best of his or her knowledge, information, and belief formed after reasonable inquiry, the filing or submission of record is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and the filing or submission of record is not made for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

(2) If a filing or submission of record is not signed, the administrative law judge shall strike the filing or submission of record, unless it is signed promptly after the omission is called to the attention of the pleader or movant.

(c) *Effect of making oral motion or argument.* The act of making any oral motion or oral argument by any counsel or party constitutes a certification that to the best of his or her knowledge, information, and belief formed after reasonable inquiry, his or her statements are well-grounded in fact and are warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and are not made

for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

§ 747.8 Conflicts of Interest.

(a) *Conflict of interest in representation.* No person shall appear as counsel for another person in an adjudicatory proceeding if it reasonably appears that such representation may be materially limited by that counsel's responsibilities to a third person or by the counsel's own interests. The administrative law judge may take corrective measures at any stage of a proceeding to cure a conflict of interest in representation, including the issuance of an order limiting the scope of representation or disqualifying an individual from appearing in a representative capacity for the duration of the proceeding.

(b) *Certification and waiver.* If any person appearing as counsel represents two or more parties to an adjudicatory proceeding or also represents a non-party on a matter relevant to an issue in the proceeding, counsel must certify in writing at the time of filing the notice of appearance required by § 747.6(a):

(1) That the counsel has personally and fully discussed the possibility of conflicts of interest with each such party and non-party; and

(2) That each such party and non-party waives any right it might otherwise have had to assert any known conflicts of interest or to assert any non-material conflicts of interest during the course of the proceeding.

§ 747.9 Ex Parte Communications.

(a) *Definition.* (1) *Ex parte communication* means any material oral or written communication relevant to the merits of an adjudicatory proceeding that was neither on the record nor on reasonable prior notice to all parties that takes place between—

(i) An interested person outside the NCUA (including such person's counsel); and

(ii) The administrative law judge handling that proceeding, the NCUA Board, or a decisional employee.

(2) *Exception.* A request for status of the proceeding does not constitute an ex parte communication.

(b) *Prohibition of ex parte communications.* From the time the notice is issued by the NCUA Board until the date that the NCUA Board issues its final decision pursuant to § 747.40(c):

(1) No interested person outside the NCUA shall make or knowingly cause to be made an ex parte communication to any member of the NCUA Board, the administrative law judge, or a decisional employee; and

(2) No member of the NCUA Board, administrative law judge, or decisional employee shall make or knowingly cause to be made to any interested person outside the NCUA any ex parte communication.

(c) *Procedure upon occurrence of ex parte communication.* If an ex parte communication is received by the administrative law judge, a member of the NCUA Board or any other person identified in paragraph (a) of this Section, that person shall cause all such written communications (or, if the communication is oral, a memorandum stating the substance of the communication) to be placed on the record of the proceeding and served on all parties. All other parties to the proceeding shall have an opportunity, within ten days of receipt of service of the ex parte communication, to file responses thereto and to recommend any sanctions, in accordance with paragraph (d) of this Section, that they believe to be appropriate under the circumstances.

(d) *Sanctions.* Any party or his or her counsel who makes a prohibited ex parte communication, or who encourages or solicits another to make any such communication, may be subject to any appropriate sanction or sanctions imposed by the NCUA Board or the administrative law judge, including, but not limited to, exclusion from the proceedings and an adverse ruling on the issue which is the subject of the prohibited communication.

(e) *Separation of functions.* Except to the extent required for the disposition of ex parte matters as authorized by law, the administrative law judge may not consult a person or party on any matter relevant to the merits of the adjudication, unless on notice and opportunity for all parties to participate. An employee or agent engaged in the performance of investigative or prosecuting functions for the NCUA in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review of the recommended decision under section 747.40, except as witness or counsel in public proceedings.

§ 747.10 Filing of Papers.

(a) *Filing.* Any papers required to be filed, excluding documents produced in response to a discovery request pursuant to §§ 747.25 and 747.26, shall be filed with the OFIA, except as otherwise provided.

(b) *Manner of filing.* Unless otherwise specified by the NCUA Board or the administrative law judge, filing may be accomplished by:

(1) Personal service;

(2) Delivering the papers to a reliable commercial courier service, overnight delivery service, or to the U.S. Post Office for Express Mail delivery;

(3) Mailing the papers by first class, registered, or certified mail; or

(4) Transmission by electronic media, only if expressly authorized, and upon any conditions specified by the NCUA Board or the administrative law judge. All papers filed by electronic media shall also concurrently be filed in accordance with paragraph (c) of this Section.

(c) *Formal requirements as to papers filed.* (1) *Form.* All papers filed must set forth the name, address, and telephone number of the counsel or party making the filing and must be accompanied by a certification setting forth when and how service has been made on all other parties. All papers filed must be double spaced and printed or typewritten on 8 1/2 x 11 inch paper, and must be clear and legible.

(2) *Signature.* All papers must be dated and signed as provided in § 747.7.

(3) *Caption.* All papers filed must include at the head thereof, or on a title page, the name of the NCUA and of the filing party, the title and docket number of the proceeding, and the subject of the particular paper.

(4) *Number of copies.* Unless otherwise specified by the NCUA Board, or the administrative law judge, an original and one copy of all documents and papers shall be filed, except that only one copy of transcripts of testimony and exhibits shall be filed.

§ 747.11 Service of Papers.

(a) *By the parties.* Except as otherwise provided, a party filing papers shall serve a copy upon the counsel of record for all other parties to the proceeding so represented, and upon any party not so represented.

(b) *Method of service.* Except as provided in paragraphs (c)(2) and (d) of this Section, a serving party shall use one or more of the following methods of service:

(1) Personal service;

(2) Delivering the papers to a reliable commercial courier service, overnight delivery service, or to the U.S. Post Office for Express Mail delivery;

(3) Mailing the papers by first class, registered, or certified mail; or

(4) Transmission by electronic media, only if the parties mutually agree. Any papers served by electronic media shall also concurrently be served in accordance with the requirements of § 747.10(c).

(c) *By the NCUA Board or the administrative law judge.* (1) All papers required to be served by the NCUA Board or the administrative law judge upon a party who has appeared in the proceeding in accordance with § 747.6, shall be served by any means specified in paragraph (b) of this section.

(2) If a party has not appeared in the proceeding in accordance with § 747.6, the NCUA Board or the administrative law judge shall make service by any of the following methods:

(i) By personal service;

(ii) If the person to be served is an individual, by delivery to a person of suitable age and discretion at the physical location where the individual resides or works;

(iii) If the person to be served is a corporation or other association, by delivery to an officer, managing or general agent, or to any other agent authorized by appointment or by law to receive service and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the party;

(iv) By registered or certified mail addressed to the person's last known address; or

(v) By any other method reasonably calculated to give actual notice.

(d) *Subpoenas.* Service of a subpoena may be made:

(1) By personal service;

(2) If the person to be served is an individual, by delivery to a person of suitable age and discretion at the physical location where the individual resides or works;

(3) By delivery to an agent, which, in the case of a corporation or other association, is delivery to an officer, managing or general

agent, or to any other agent authorized by appointment or by law to receive service and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the party;

(4) By registered or certified mail addressed to the person's last known address; or

(5) By any other method reasonably calculated to give actual notice.

(e) *Area of service.* Service in any state, territory, possession of the United States, or the District of Columbia, on any person or company doing business in any state, territory, possession of the United States, or the District of Columbia, or on any person as otherwise provided by law, is effective without regard to the place where the hearing is held, provided that if service is made on a foreign bank in connection with an action or proceeding involving one or more of its branches or agencies located in any state, territory, possession of the United States, or the District of Columbia, service shall be made on at least one branch or agency so involved.

§ 747.12 Construction of Time Limits.

(a) *General rule.* In computing any period of time prescribed by this subpart, the date of the act or event that commences the designated period of time is not included. The last day so computed is included unless it is a Saturday, Sunday, or Federal holiday. When the last day is a Saturday, Sunday, or Federal holiday, the period runs until the end of the next day that is not a Saturday, Sunday, or Federal holiday. Intermediate Saturdays, Sundays, and Federal holidays are included in the computation of time. However, when the time period within which an act is to be performed is ten days or less, not including any additional time allowed for in § 747.12(c), intermediate Saturdays, Sundays, and Federal holidays are not included.

(b) *When papers are deemed to be filed or served.*

(1) Filing and service are deemed to be effective:

(i) In the case of personal service or same day commercial courier delivery, upon actual service;

(ii) In the case of overnight commercial delivery service, U.S. Express Mail delivery, or first class, registered, or certified mail, upon deposit in or delivery to an appropriate point of collection;

(iii) In the case of transmission by electronic media, as specified by the authority receiving the filing, in the case of filing, and as agreed among the parties, in the case of service.

(2) The effective filing and service dates specified in paragraph (b)(1) of this Section may be modified by the NCUA Board or administrative law judge in the case of filing or by agreement of the parties in the case of service.

(c) *Calculation of time for service and filing of responsive papers.* Whenever a time limit is measured by a prescribed period from the service of any notice or paper, the applicable time limits are calculated as follows:

(1) If service is made by first class, registered, or certified mail, add three calendar days to the prescribed period;

(2) If service is made by express mail or overnight delivery service, add one calendar day to the prescribed period; or

(3) If service is made by electronic media transmission, add one calendar day to the prescribed period, unless otherwise determined by the NCUA Board or the administrative law judge in the case of filing, or by agreement among the parties in the case of service.

§ 747.13 Change of Time Limits.

Except as otherwise provided by law, the administrative law judge may, for good cause shown, extend the time limits prescribed by the Uniform Rules or by any notice or order issued in the proceedings. After the referral of the case to the NCUA Board pursuant to § 747.38, the NCUA Board may grant extensions of the time limits for good cause shown. Extensions may be granted upon the motion of a party after notice and opportunity to respond is afforded all non-moving parties, or upon the NCUA Board's or the administrative law judge's own motion.

§ 747.14 Witness Fees and Expenses.

Witnesses subpoenaed for testimony or dep ositions shall be paid the same fees for attendance and mileage as are paid in the United States district courts in proceedings in which the United States is a party, provided that, in the case of a discovery subpoena addressed to a party, no witness fees or mileage need be paid. Fees for witnesses shall be tendered in advance by the party requesting the subpoena, except that fees and

mileage need not be tendered in advance where the NCUA is the party requesting the subpoena. The NCUA shall not be required to pay any fees to, or expenses of, any witness not subpoenaed by the NCUA.

§ 747.15 Opportunity for Informal Settlement.

Any respondent may, at any time in the proceeding, unilaterally submit to Enforcement Counsel written offers or proposals for settlement of a proceeding, without prejudice to the rights of any of the parties. No such offer or proposal shall be made to any NCUA representative other than Enforcement Counsel. Submission of a written settlement offer does not provide a basis for adjourning or otherwise delaying all or any portion of a proceeding under this Part. No settlement offer or proposal, or any subsequent negotiation or resolution, is admissible as evidence in any proceeding.

§ 747.16 NCUA's Right to Conduct Examination.

Nothing contained in this Subpart limits in any manner the right of the NCUA to conduct any examination, inspection, or visitation of any institution or institution-affiliated party, or the right of the NCUA to conduct or continue any form of investigation authorized by law.

§ 747.17 Collateral Attacks on Adjudicatory Proceeding.

If an interlocutory appeal or collateral attack is brought in any court concerning all or any part of an adjudicatory proceeding, the challenged adjudicatory proceeding shall continue without regard to the pendency of that court proceeding. No default or other failure to act as directed in the adjudicatory proceeding within the times prescribed in this Subpart shall be excused based on the pendency before any court of any interlocutory appeal or collateral attack.

§ 747.18 Commencement of Proceeding and Contents of Notice.

(a) *Commencement of proceeding.* (1) A proceeding governed by this Subpart is commenced by issuance of a notice by the NCUA Board.

(2) The notice must be served by the NCUA Board upon the respondent and given to any other appropriate financial institution supervisory authority where required by law.

(3) The notice must be filed with the OFIA.

(b) *Contents of notice.* The notice must set forth:

(1) The legal authority for the proceeding and for the NCUA's jurisdiction over the proceeding;

(2) A statement of the matters of fact or law showing that the NCUA is entitled to relief;

(3) A proposed order or prayer for an order granting the requested relief;

(4) The time, place, and nature of the hearing as required by law or regulation;

(5) The time within which to file an answer as required by law or regulation;

(6) The time within which to request a hearing as required by law or regulation; and

(7) That the answer and/or request for a hearing shall be filed with OFIA.

§ 747.19 Answer.

(a) *When.* Within 20 days of service of the notice, respondent shall file an answer as designated in the notice. In a civil money penalty proceeding, respondent shall also file a request for a hearing within 20 days of service of the notice.

(b) *Content of answer.* An answer must specifically respond to each paragraph or allegation of fact contained in the notice and must admit, deny, or state that the party lacks sufficient information to admit or deny each allegation of fact. A statement of lack of information has the effect of a denial. Denials must fairly meet the substance of each allegation of fact denied; general denials are not permitted. When a respondent denies part of an allegation, that part must be denied and the remainder specifically admitted. Any allegation of fact in the notice which is not denied in the answer must be deemed admitted for purposes of the proceeding. A respondent is not required to respond to the portion of a notice that constitutes the prayer for relief or proposed order. The answer must set forth affirmative defenses, if any, asserted by the respondent.

(c) *Default.* (1) *Effect of failure to answer.* Failure of a respondent to file an answer required by this Section within the time provided constitutes a waiver of his or her right to appear and contest the allegations in the notice. If no timely answer is filed, the administrative law judge, upon motion of the Enforcement Counsel, shall file with the NCUA Board a recommended decision containing the findings and the relief sought in the notice. Any final order issued by the NCUA Board based upon a respondent's failure to answer is deemed to be an order issued upon consent.

(2) *Effect of failure to request a hearing in civil money penalty proceedings.* If respondent fails to request a hearing as required by law within the time provided, the notice of assessment constitutes a final and unappealable order.

§ 747.20 Amended Pleadings.

(a) *Amendments.* The notice or answer may be amended or supplemented at any stage of the proceeding. The respondent must answer an amended notice within the time remaining for the respondent's answer to the original notice, or within ten days after service of the amended notice, whichever period is longer, unless the NCUA Board or administrative law judge orders otherwise for good cause.

(b) *Amendments to conform to the evidence.* When issues not raised in the notice or answer are tried at the hearing by express or implied consent of the parties, they will be treated in all respects as if they had been raised in the notice or answer, and no formal amendments are required. If evidence is objected to at the hearing on the ground that it is not within the issues raised by the notice or answer, the administrative law judge may admit the evidence when admission is likely to assist in adjudicating the merits of the action and the objecting party fails to satisfy the administrative law judge that the admission of such evidence would unfairly prejudice that party's action or defense upon the merits. The administrative law judge may grant a continuance to enable the objecting party to meet such evidence.

§ 747.21 Failure to Appear.

(a) Failure of a respondent to appear in person at the hearing or by a duly authorized counsel constitutes a waiver of respondent's right to a hearing and is deemed an admission of the facts as alleged and consent to the relief sought in the notice. Without further proceedings or notice to the respondent, the administrative law judge shall file with the NCUA Board a recommended decision containing the findings and the relief sought in the notice.

§ 747.22 Consolidation and Severance of Actions.

(a) *Consolidation.* (1) On the motion of any party, or on the administrative law judge's own motion, the administrative law judge may consolidate, for some or all purposes, any two or more proceedings, if each such proceeding involves or arises out of the same transaction, occurrence or series of transactions or occurrences, or involves at least one common respondent or a material common question of law or fact, unless such consolidation would cause unreasonable delay or injustice.

(2) In the event of consolidation under paragraph (a)(1) of this Section, appropriate adjustment to the prehearing schedule must be made to avoid unnecessary expense, inconvenience, or delay.

(b) *Severance.* The administrative law judge may, upon the motion of any party, sever the proceeding for separate resolution of the matter as to any respondent only if the administrative law judge finds that:

(1) Undue prejudice or injustice to the moving party would result from not severing the proceeding; and

(2) Such undue prejudice or injustice would outweigh the interests of judicial economy and expedition in the complete and final resolution of the proceeding.

§ 747.23 Motions.

(a) *In writing.* (1) Except as otherwise provided herein, an application or request for an order or ruling must be made by written motion.

(2) All written motions must state with particularity the relief sought and must be accompanied by a proposed order.

(3) No oral argument may be held on written motions except as otherwise directed by the administrative law judge. Written memoranda, briefs, affidavits, or other relevant material or documents may be filed in support of or in opposition to a motion.

(b) *Oral motions.* A motion may be made orally on the record unless the administrative law judge directs that such motion be reduced to writing.

(c) *Filing of motions.* Motions must be filed with the administrative law judge, except that upon the filing of the recommended decision, motions must be filed with the NCUA Board.

(d) *Responses.* (1) Except as otherwise provided herein, within ten days after service of any written motion, or within such other period of time as may be established by the administrative law judge or the NCUA Board, any party may file a written response to a motion. The administrative law judge shall not rule on any oral or written motion before each party has had an opportunity to file a response.

(2) The failure of a party to oppose a written motion or an oral motion made on the record is deemed a consent by that party to the entry of an order substantially in the form of the order accompanying the motion.

(e) *Dilatory motions.* Frivolous, dilatory or repetitive motions are prohibited. The filing of such motions may form the basis for sanctions.

(f) *Dispositive motions.* Dispositive motions are governed by §§ 747.29 and 747.30.

§ 747.24 Scope of Document Discovery.

(a) *Limits on discovery.* (1) Subject to the limitations set out in paragraphs (b), (c), and (d) of this section, a party to a proceeding under this subpart may obtain document discovery by serving a written request to produce documents. For purposes of a request to produce documents, the term "documents" may be defined to include drawings, graphs, charts, photographs, recordings, data stored in electronic form, and other data compilations from which information can be obtained, or translated, if necessary, by the parties through detection devices into reasonably usable form, as well as written material of all kinds.

(2) Discovery by use of deposition is governed by subpart I of this part.

(3) Discovery by use of interrogatories is not permitted.

(b) *Relevance.* A party may obtain document discovery regarding any matter, not privileged, that has material relevance to the merits of the pending action. Any request to produce documents that calls for irrelevant material, that is unreasonable, oppressive, excessive in scope, unduly burdensome, or repetitive of previous requests, or that seeks to obtain privileged documents will be denied or modified. A request is unreasonable, oppressive, excessive in scope, or unduly burdensome if, among other things, it fails to include justifiable limitations on the time period covered and the geographic locations to be searched, the time provided to respond in the request is inadequate, or the request calls for copies of documents to be delivered to the requesting party and fails to include the requester's written agreement to pay in advance for the copying, in accordance with § 747.25.

(c) *Privileged matter.* Privileged documents are not discoverable. Privileges include the attorney-client privilege, work-product privilege, any government's or government agency's deliberative-process privilege, and any other privileges the Constitution, any applicable act of Congress, or the principles of common law provide.

(d) *Time limits.* All discovery, including all responses to discovery requests, shall be completed at least 20 days prior to the date scheduled for the commencement of the hearing, except as provided in the Local Rules. No exceptions to this time limit shall be permitted, unless the administrative law judge finds on the record that good cause exists for waiving the requirements of this paragraph.

§ 747.25 Request for Document Discovery from Parties.

(a) *General rule.* Any party may serve on any other party a request to produce for inspection any discoverable documents that are in the possession, custody, or control of the party upon whom the request is served. The request must identify the documents to be produced either by individual item or by category, and must describe each item and category with reasonable particularity. Documents must be produced as they are kept in the usual course of business or must be organized to correspond with the categories in the request.

(b) *Production or copying.* The request must specify a reasonable time, place, and manner for production and performing any related acts. In lieu of inspecting the documents, the requesting party may specify that all or some of the responsive documents be copied and the copies delivered to the requesting party. If copying of fewer than 250 pages is requested, the party to whom the request is addressed shall bear the cost of copying and shipping charges. If a party requests 250 pages or more of copying, the requesting party shall pay

for the copying and shipping charges. Copying charges are the current per-page copying rate imposed by 12 CFR § 792.5 implementing the Freedom of Information Act (5 U.S.C. 552). The party to whom the request is addressed may require payment in advance before producing the documents.

(c) *Obligation to update responses.* A party who has responded to a discovery request with a response that was complete when made is not required to supplement the response to include documents thereafter acquired, unless the responding party learns that:

(1) The response was materially incorrect when made; or

(2) The response, though correct when made, is no longer true and a failure to amend the response is, in substance, a knowing concealment.

(d) *Motions to limit discovery.* (1) Any party that objects to a discovery request may, within ten days of being served with such request, file a motion in accordance with the provisions of § 747.23 to strike or otherwise limit the request. If an objection is made to only a portion of an item or category in a request, the portion objected to shall be specified. Any objections not made in accordance with this paragraph and § 747.23 are waived.

(2) The party who served the request that is the subject of a motion to strike or limit may file a written response within five days of service of the motion. No other party may file a response.

(e) *Privilege.* At the time other documents are produced, the producing party must reasonably identify all documents withheld on the grounds of privilege and must produce a statement of the basis for the assertion of privilege. When similar documents that are protected by deliberative process, attorney work-product, or attorney-client privilege are voluminous, these documents may be identified by category instead of by individual document. The administrative law judge retains discretion to determine when the identification by category is insufficient.

(f) *Motions to compel production.* (1) If a party withholds any documents as privileged or fails to comply fully with a discovery request, the requesting party may, within ten days of the assertion of privilege or of the time the failure to comply becomes known to the requesting party, file a motion in accordance with the provisions of § 747.23 for the issuance of a subpoena compelling production.

(2) The party who asserted the privilege or failed to comply with the request may file a written response to a motion to compel within five days of service of the motion. No other party may file a response.

(g) *Ruling on motions.* After the time for filing responses pursuant to this section has expired, the administrative law judge shall rule promptly on all motions filed pursuant to this section. If the administrative law judge determines that a discovery request, or any of its terms, calls for irrelevant material, is unreasonable, oppressive, excessive in scope, unduly burdensome, or repetitive of previous requests, or seeks to obtain privileged documents, he or she may deny or modify the request, and may issue appropriate protective orders, upon such conditions as justice may require. The pendency of a motion to strike or limit discovery or to compel production is not a basis for staying or continuing the proceeding, unless otherwise ordered by the administrative law judge. Notwithstanding any other provision in this part, the administrative law judge may not release, or order a party to produce, documents withheld on grounds of privilege if the party has stated to the administrative law judge its intention to file a timely motion for interlocutory review of the administrative law judge's order to produce the documents, and until the motion for interlocutory review has been decided.

(h) *Enforcing discovery subpoenas.* If the administrative law judge issues a subpoena compelling production of documents by a party, the subpoenaing party may, in the event of noncompliance and to the extent authorized by applicable law, apply to any appropriate United States district court for an order requiring compliance with the subpoena. A party's right to seek court enforcement of a subpoena shall not in any manner limit the sanctions that may be imposed by the administrative law judge against a party who fails to produce subpoenaed documents.

§ 747.26 Document Subpoenas to Nonparties.

(a) *General rules.* (1) Any party may apply to the administrative law judge for the issuance of a document discovery subpoena addressed to any person who is not a party to the proceeding. The application must contain a proposed document subpoena and a brief statement showing the general relevance and reasonableness of the scope of documents sought. The subpoenaing party shall

specify a reasonable time, place, and manner for making production in response to the document subpoena.

(2) A party shall only apply for a document subpoena under this Section within the time period during which such party could serve a discovery request under § 747.24(d). The party obtaining the document subpoena is responsible for serving it on the subpoenaed person and for serving copies on all parties. Document subpoenas may be served in any state, territory, or possession of the United States, the District of Columbia, or as otherwise provided by law.

(3) The administrative law judge shall promptly issue any document subpoena requested pursuant to this Section. If the administrative law judge determines that the application does not set forth a valid basis for the issuance of the subpoena, or that any of its terms are unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena or may issue it in a modified form upon such conditions as may be consistent with the Uniform Rules.

(b) *Motion to quash or modify.* (1) Any person to whom a document subpoena is directed may file a motion to quash or modify such subpoena, accompanied by a statement of the basis for quashing or modifying the subpoena. The movant shall serve the motion on all parties, and any party may respond to such motion within ten days of service of the motion.

(2) Any motion to quash or modify a document subpoena must be filed on the same basis, including the assertion of privilege, upon which a party could object to a discovery request under § 747.25(d), and during the same time limits during which such an objection could be filed.

(c) *Enforcing document subpoenas.* If a subpoenaed person fails to comply with any subpoena issued pursuant to this Section or any order of the administrative law judge which directs compliance with all or any portion of a document subpoena, the subpoenaing party or any other aggrieved party may, to the extent authorized by applicable law, apply to an appropriate United States district court for an order requiring compliance with so much of the document subpoena as the administrative law judge has not quashed or modified. A party's right to seek court enforcement of a document subpoena shall in no way limit the sanctions that may be imposed by the administrative law judge on a party who induces a failure to comply with subpoenas issued under this Section.

§ 747.27 Deposition of Witness Unavailable for Hearing.

(a) *General rules.* (1) If a witness will not be available for the hearing, a party desiring that witness's testimony for the record may apply in accordance with the procedures set forth in paragraph (a)(2) of this Section, to the administrative law judge for the issuance of a subpoena, including a subpoena duces tecum, requiring the attendance of the witness at a deposition. The administrative law judge may issue a deposition subpoena under this Section upon showing that:

(i) The witness will be unable to attend or may be prevented from attending the hearing because of age, sickness or infirmity, or will otherwise be unavailable;

(ii) The witness's unavailability was not procured or caused by the subpoenaing party;

(iii) The testimony is reasonably expected to be material; and

(iv) Taking the deposition will not result in any undue burden to any other party and will not cause undue delay of the proceeding.

(2) The application must contain a proposed deposition subpoena and a brief statement of the reasons for the issuance of the subpoena. The subpoena must name the witness whose deposition is to be taken and specify the time and place for taking the deposition. A deposition subpoena may require the witness to be deposed at any place within the country in which that witness resides or has a regular place of employment or such other convenient place as the administrative law judge shall fix.

(3) Any requested subpoena that sets forth a valid basis for its issuance must be promptly issued, unless the administrative law judge on his or her own motion, requires a written response or requires attendance at a conference concern ing whether the requested subpoena should be issued.

(4) The party obtaining a deposition subpoena is responsible for serving it on the witness and for serving copies on all parties. Unless the administrative law judge orders otherwise, no deposition under this Section shall be taken on fewer than ten days' notice to the witness and all parties. Deposition subpoenas may be served in any state, territory, or possession of the United States, or the District of Columbia, on any person or company doing business in any state, territory, or possession of

the United States, or the District of Columbia, or as otherwise permitted by law.

(b) *Objections to deposition subpoenas.* (1) The witness and any party who has not had an opportunity to oppose a deposition subpoena issued under this Section may file a motion with the administrative law judge to quash or modify the subpoena prior to the time for compliance specified in the subpoena, but not more than ten days after service of the subpoena.

(2) A statement of the basis for the motion to quash or modify a subpoena issued under this Section must accompany the motion. The motion must be served on all parties.

(c) *Procedure upon deposition.* (1) Each witness testifying pursuant to a deposition subpoena must be duly sworn, and each party shall have the right to examine the witness. Objections to questions or documents must be in short form, stating the grounds for the objection. Failure to object to questions or documents is not deemed a waiver except where the ground for the objection might have been avoided if the objection had been timely presented. All questions, answers, and objections must be recorded.

(2) Any party may move before the administrative law judge for an order compelling the witness to answer any questions the witness has refused to answer or submit any evidence the witness has refused to submit during the deposition.

(3) The deposition must be subscribed by the witness, unless the parties and the witness, by stipulation, have waived the signing, or the witness is ill, cannot be found, or has refused to sign. If the deposition is not subscribed by the witness, the court reporter taking the deposition shall certify that the transcript is a true and complete transcript of the deposition.

(d) *Enforcing subpoenas.* If a subpoenaed person fails to comply with any order of the administrative law judge which directs compliance with all or any portion of a deposition subpoena under paragraph (b) or (c)(3) of this Section, the subpoenaing party or other aggrieved party may, to the extent authorized by applicable law, apply to an appropriate United States district court for an order requiring compliance with the portions of the subpoena that the administrative law judge has ordered enforced. A party's right to seek court enforcement of a deposition subpoena in no way limits the sanctions that may be imposed by the administrative law judge on a party who fails to comply with, or procures a failure to comply with, a subpoena issued under this Section.

§ 747.28 Interlocutory Review.

(a) *General rule.* The NCUA Board may review a ruling of the administrative law judge prior to the certification of the record to the NCUA Board only in accordance with the procedures set forth in this Section and § 747.23.

(b) *Scope of review.* The NCUA Board may exercise interlocutory review of a ruling of the administrative law judge if the NCUA Board finds that:

(1) The ruling involves a controlling question of law or policy as to which substantial grounds exist for a difference of opinion;

(2) Immediate review of the ruling may materially advance the ultimate termination of the proceeding;

(3) Subsequent modification of the ruling at the conclusion of the proceeding would be an inadequate remedy; or

(4) Subsequent modification of the ruling would cause unusual delay or expense.

(c) *Procedure.* Any request for interlocutory review shall be filed by a party with the administrative law judge within ten days of his or her ruling and shall otherwise comply with § 747.23. Any party may file a response to a request for interlocutory review in accordance with § 747.23(d). Upon the expiration of the time for filing all responses, the administrative law judge shall refer the matter to the NCUA Board for final disposition.

(d) *Suspension of proceeding.* Neither a request for interlocutory review nor any disposition of such a request by the NCUA Board under this Section suspends or stays the proceeding unless other wise ordered by the administrative law judge or the NCUA Board.

§ 747.29 Summary Disposition.

(a) *In general.* The administrative law judge shall recommend that the NCUA Board issue a final order granting a motion for summary disposition if the undisputed pleaded facts, admissions, affidavits, stipulations, documentary evidence, matters as to which official notice may be taken, and any other evidentiary materials properly submitted in connection with a motion for summary disposition show that:

(1) There is no genuine issue as to any material fact; and

(2) The moving party is entitled to a decision in its favor as a matter of law.

(b) *Filing of motions and responses.* (1) Any party who believes that there is no genuine issue

of material fact to be determined and that he or she is entitled to a decision as a matter of law may move at any time for summary disposition in its favor of all or any part of the proceeding. Any party, within 20 days after service of such a motion, or within such time period as allowed by the administrative law judge, may file a response to such motion.

(2) A motion for summary disposition must be accompanied by a statement of the material facts as to which the moving party contends there is no genuine issue. Such motion must be supported by documentary evidence, which may take the form of admissions in pleadings, stipulations, depositions, investigatory depositions, transcripts, affidavits and any other evidentiary materials that the moving party contends support his or her position. The motion must also be accompanied by a brief containing the points and authorities in support of the contention of the moving party. Any party opposing a motion for summary disposition must file a statement setting forth those material facts as to which he or she contends a genuine dispute exists. Such opposition must be supported by evidence of the same type as that submitted with the motion for summary disposition and a brief containing the points and authorities in support of the contention that summary disposition would be inappropriate.

(c) *Hearing on motion.* At the request of any party or on his or her own motion, the administrative law judge may hear oral argument on the motion for summary disposition.

(d) *Decision on motion.* Following receipt of a motion for summary disposition and all responses thereto, the administrative law judge shall determine whether the moving party is entitled to summary disposition. If the administrative law judge determines that summary disposition is warranted, the administrative law judge shall submit a recommended decision to that effect to the NCUA Board. If the administrative law judge finds that no party is entitled to summary disposition, he or she shall make a ruling denying the motion.

§ 747.30 Partial Summary Disposition.

If the administrative law judge determines that a party is entitled to summary disposition as to certain claims only, he or she shall defer submitting a recommended decision as to those claims. A hearing on the remaining issues must be ordered. Those claims for which the administrative law judge has determined that summary disposition is warranted will be addressed in the recommended decision filed at the conclusion of the hearing.

§ 747.31 Scheduling and Prehearing Conferences.

(a) *Scheduling conference.* Within 30 days of service of the notice or order commencing a proceeding or such other time as parties may agree, the administrative law judge shall direct counsel for all parties to meet with him or her in person at a specified time and place prior to the hearing or to confer by telephone for the purpose of scheduling the course and conduct of the proceeding. This meeting or telephone conference is called a "scheduling conference." The identification of potential witnesses, the time for and manner of discovery, and the exchange of any prehearing materials including witness lists, statements of issues, stipulations, exhibits and any other materials may also be determined at the scheduling conference.

(b) *Prehearing conferences.* The administrative law judge may, in addition to the scheduling conference, on his or her own motion or at the request of any party, direct counsel for the parties to meet with him or her (in person or by telephone) at a prehearing conference to address any or all of the following:

(1) Simplification and clarification of the issues;

(2) Stipulations, admissions of fact, and the contents, authenticity and admissibility into evidence of documents;

(3) Matters of which official notice may be taken;

(4) Limitation of the number of witnesses;

(5) Summary disposition of any or all issues;

(6) Resolution of discovery issues or disputes;

(7) Amendments to pleadings; and

(8) Such other matters as may aid in the orderly disposition of the proceeding.

(c) *Transcript.* The administrative law judge, in his or her discretion, may require that a scheduling or prehearing conference be recorded by a court reporter. A transcript of the conference and any materials filed, including orders, becomes part of the record of the proceeding. A party may obtain a copy of the transcript at its expense.

(d) *Scheduling or prehearing orders.* At or within a reasonable time following the conclusion of the scheduling conference or any prehearing conference, the administrative law judge shall serve on each party an order setting forth any agreements reached and any procedural determinations made.

§ 747.32 Prehearing Submissions.

(a) Within the time set by the administrative law judge, but in no case later than 14 days before the start of the hearing, each party shall serve on every other party, his or her:

(1) Prehearing statement;

(2) Final list of witnesses to be called to testify at the hearing, including name and address of each witness and a short summary of the expected testimony of each witness;

(3) List of the exhibits to be introduced at the hearing along with a copy of each exhibit; and

(4) Stipulations of fact, if any.

(b) *Effect of failure to comply.* No witness may testify and no exhibits may be introduced at the hearing if such witness or exhibit is not listed in the prehearing submissions pursuant to paragraph (a) of this Section, except for good cause shown.

§ 747.33 Public Hearings.

(a) *General rule.* All hearings shall be open to the public, unless the NCUA Board, in its discretion, determines that holding an open hearing would be contrary to the public interest. Within 20 days of service of the notice, any respondent may file with the NCUA Board a request for a private hearing, and any party may file a reply to such a request. A party must serve on the administrative law judge a copy of any request or reply the party files with the NCUA Board. The form of, and procedure for, these requests and replies are governed by § 747.23. A party's failure to file a request or a reply constitutes a waiver of any objections regarding whether the hearing will be public or private.

(b) *Filing document under seal.* Enforcement Counsel, in his or her discretion, may file any document or part of a document under seal if disclosure of the document would be contrary to the public interest. The administrative law judge shall take all appropriate steps to preserve the confidentiality of such documents or parts thereof, including closing portions of the hearing to the public.

§ 747.34 Hearing Subpoenas.

(a) *Issuance.* (1) Upon application of a party showing general relevance and reasonableness of scope of the testimony or other evidence sought, the administrative law judge may issue a subpoena or a subpoena *duces tecum* requiring the attendance of a witness at the hearing or the production of documentary or physical evidence at the hearing. The application for a hearing subpoena must also contain a proposed subpoena specifying the attendance of a witness or the production of evidence from any state, territory, or possession of the United States, the District of Columbia, or as otherwise provided by law at any designated place where the hearing is being conducted. The party making the application shall serve a copy of the application and the proposed subpoena on every other party.

(2) A party may apply for a hearing subpoena at any time before the commencement of a hearing. During a hearing, a party may make an application for a subpoena orally on the record before the administrative law judge.

(3) The administrative law judge shall promptly issue any hearing subpoena requested pursuant to this section. If the administrative law judge determines that the application does not set forth a valid basis for the issuance of the subpoena, or that any of its terms are unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena or may issue it in a modified form upon any conditions consistent with this subpart. Upon issuance by the administrative law judge, the party making the application shall serve the subpoena on the person named in the subpoena and on each party.

(b) *Motion to quash or modify.* (1) Any person to whom a hearing subpoena is directed or any party may file a motion to quash or modify the subpoena, accompanied by a statement of the basis for quashing or modifying the subpoena. The movant must serve the motion on each party and on the person named in the subpoena. Any party may

respond to the motion within ten days of service of the motion.

(2) Any motion to quash or modify a hearing subpoena must be filed prior to the time specified in the subpoena for compliance, but not more than ten days after the date of service of the subpoena upon the movant.

(c) *Enforcing subpoenas.* If a subpoenaed person fails to comply with any subpoena issued pursuant to this Section or any order of the administrative law judge which directs compliance with all or any portion of a document subpoena, the subpoenaing party or any other aggrieved party may seek enforcement of the subpoena pursuant to § 747.26(c).

§ 747.35 Conduct of Hearings.

(a) *General rules.* (1) Hearings shall be conducted so as to provide a fair and expeditious presentation of the relevant disputed issues. Each party has the right to present its case or defense by oral and documentary evidence and to conduct such cross examination as may be required for full disclosure of the facts.

(2) *Order of hearing.* Enforcement Counsel shall present its case-in-chief first, unless otherwise ordered by the administrative law judge, or unless otherwise expressly specified by law or regulation. Enforcement Counsel shall be the first party to present an opening statement and a closing statement, and may make a rebuttal statement after the respondent's closing statement. If there are multiple respondents, respondents may agree among themselves as to their order of presentation of their cases, but if they do not agree the administrative law judge shall fix the order.

(3) Examination of witnesses. Only one counsel for each party may conduct an examination of a witness, except that in the case of extensive direct examination, the administrative law judge may permit more than one counsel for the party presenting the witness to conduct the examination. A party may have one counsel conduct the direct examination and another counsel conduct re-direct examination of a witness, or may have one counsel conduct the cross examination of a witness and another counsel conduct the re-cross examination of a witness.

(4) *Stipulations.* Unless the administrative law judge directs otherwise, all stipulations of fact and law previously agreed upon by the parties, and all documents, the admissibility of which have been previously stipulated, will be admitted into evidence upon commencement of the hearing.

(b) *Transcript.* The hearing must be recorded and transcribed. The reporter will make the transcript available to any party upon payment by that party to the reporter of the cost of the transcript. The administrative law judge may order the record corrected, either upon motion to correct, upon stipulation of the parties, or following notice to the parties upon the administrative law judge's own motion.

§ 747.36 Evidence.

(a) *Admissibility.* (1) Except as is otherwise set forth in this Section, relevant, material, and reliable evidence that is not unduly repetitive is admissible to the fullest extent authorized by the Administrative Procedure Act and other applicable law.

(2) Evidence that would be admissible under the Federal Rules of Evidence is admissible in a proceeding conducted pursuant to this Subpart.

(3) Evidence that would be inadmissible under the Federal Rules of Evidence may not be deemed or ruled to be inadmissible in a proceeding conducted pursuant to this Subpart if such evidence is relevant, material, reliable and not unduly repetitive.

(b) *Official notice.* (1) Official notice may be taken of any material fact which may be judicially noticed by a United States district court and any material information in the official public records of any Federal or state government agency.

(2) All matters officially noticed by the administrative law judge or NCUA Board shall appear on the record.

(3) If official notice is requested or taken of any material fact, the parties, upon timely request, shall be afforded an opportunity to object.

(c) *Documents.* (1) A duplicate copy of a document is admissible to the same extent as the original, unless a genuine issue is raised as to whether the copy is in some material respect not a true and legible copy of the original.

(2) Subject to the requirements of paragraph (a) of this Section, any document, including a report of examination, supervisory activity, inspection or visitation, prepared by an appropriate Federal financial institution regulatory agency or by a state regulatory agency, is

admissible either with or without a sponsoring witness.

(3) Witnesses may use existing or newly created charts, exhibits, calendars, calculations, outlines or other graphic material to summarize, illustrate, or simplify the presentation of testimony. Such materials may, subject to the administrative law judge's discretion, be used with or without being admitted into evidence.

(d) *Objections.* (1) Objections to the admissibility of evidence must be timely made and rulings on all objections must appear on the record.

(2) When an objection to a question or line of questioning propounded to a witness is sustained, the examining counsel may make a specific proffer on the record of what he or she expected to prove by the expected testimony of the witness, either by representation of counsel or by direct interrogation of the witness.

(3) The administrative law judge shall retain rejected exhibits, adequately marked for identification, for the record, and transmit such exhibits to the NCUA Board.

(4) Failure to object to admission of evidence or to any ruling constitutes a waiver of the objection.

(e) *Stipulations.* The parties may stipulate as to any relevant matters of fact or the authentication of any relevant documents. Such stipulations must be received in evidence at a hearing, and are binding on the parties with respect to the matters therein stipulated.

(f) *Depositions of unavailable witnesses.* (1) If a witness is unavailable to testify at a hearing, and that witness has testified in a deposition to which all parties in a proceeding had notice and an opportunity to participate, a party may offer as evidence all or any part of the transcript of the deposition, including deposition exhibits, if any.

(2) Such deposition transcript is admissible to the same extent that testimony would have been admissible had that person testified at the hearing, provided that if a witness refused to answer proper questions during the deposition, the administrative law judge may, on that basis, limit the admissibility of the deposition in any manner that justice requires.

(3) Only those portions of a deposition received in evidence at the hearing constitute a part of the record.

§ 747.37 Post-hearing Filings.

(a) *Proposed findings and conclusions and supporting briefs.* (1) Using the same method of service for each party, the administrative law judge shall serve notice upon each party that the certified transcript, together with all hearing exhibits and exhibits introduced but not admitted into evidence at the hearing, has been filed. Any party may file with the administrative law judge proposed findings of fact, proposed conclusions of law, and a proposed order within 30 days following service of this notice by the administrative law judge or within such longer period as may be ordered by the administrative law judge.

(2) Proposed findings and conclusions must be supported by citation to any relevant authorities and by page references to any relevant portions of the record. A post-hearing brief may be filed in support of proposed findings and conclusions, either as part of the same document or in a separate document. Any party who fails to file timely with the administrative law judge any proposed finding or conclusion is deemed to have waived the right to raise in any subsequent filing or submission any issue not addressed in such party's proposed finding or conclusion.

(b) *Reply briefs.* Reply briefs may be filed within 15 days after the date on which the parties' proposed findings, conclusions, and order are due. Reply briefs must be strictly limited to responding to new matters, issues, or arguments raised in another party's papers. A party who has not filed proposed findings of fact and conclusions of law or a post-hearing brief may not file a reply brief.

(c) *Simultaneous filing required.* The administrative law judge shall not order the filing by any party of any brief or reply brief in advance of the other party's filing of its brief.

§ 747.38 Recommended Decision and Filing of Record.

(a) *Filing of recommended decision and record.* Within 45 days after expiration of the time allowed for filing reply briefs under § 747.37(b), the administrative law judge shall file with and certify to the NCUA Board, for decision, the record of the proceeding. The record must include the administrative law judge's recommended decision, recommended findings of fact, recommended conclu-

sions of law, and proposed order; all prehearing and hearing transcripts, exhibits, and rulings; and the motions, briefs, memoranda, and other supporting papers filed in connection with the hearing. The administrative law judge shall serve upon each party the recommended decision, findings, conclusions, and proposed order.

(b) *Filing of index.* At the same time the administrative law judge files with and certifies to the NCUA Board for final determination the record of the proceeding, the administrative law judge shall furnish to the NCUA Board a certified index of the entire record of the proceeding. The certified index shall include, at a minimum, an entry for each paper, document or motion filed with the administrative law judge in the proceeding, the date of the filing, and the identity of the filer. The certified index shall also include an exhibit index containing, at a minimum, an entry consisting of exhibit number and title or description for: Each exhibit introduced and admitted into evidence at the hearing; each exhibit introduced but not admitted into evidence at the hearing; each exhibit introduced and admitted into evidence after the completion of the hearing; and each exhibit introduced but not admitted into evidence after the completion of the hearing.

§ 747.39 Exceptions to Recommended Decision.

(a) *Filing exceptions.* Within 30 days after service of the recommended decision, findings, conclusions, and proposed order under § 747.38, a party may file with the NCUA Board written exceptions to the administrative law judge's recommended decision, findings, conclusions or proposed order, to the admission or exclusion of evidence, or to the failure of the administrative law judge to make a ruling proposed by a party. A supporting brief may be filed at the time the exceptions are filed, either as part of the same document or in a separate document.

(b) *Effect of failure to file or raise exceptions.* (1) Failure of a party to file exceptions to those matters specified in paragraph (a) of this Section within the time prescribed is deemed a waiver of objection thereto.

(2) No exception need be considered by the NCUA Board if the party taking exception had an opportunity to raise the same objection, issue, or argument before the administrative law judge and failed to do so.

(c) *Contents.* (1) All exceptions and briefs in support of such exceptions must be confined to the particular matters in, or omissions from, the administrative law judge's recommendations to which that party takes exception.

(2) All exceptions and briefs in support of exceptions must set forth page or paragraph references to the specific parts of the administrative law judge's recommendations to which exception is taken, the page or paragraph references to those portions of the record relied upon to support each exception, and the legal authority relied upon to support each exception.

§ 747.40 Review by the NCUA Board.

(a) *Notice of submission to NCUA Board.* When the NCUA Board determines that the record in the proceeding is complete, the NCUA Board shall serve notice upon the parties that the proceeding has been submitted to the NCUA Board for final decision.

(b) *Oral argument before NCUA Board.* Upon the initiative of the NCUA Board or on the written request of any party filed with the NCUA Board within the time for filing exceptions, the NCUA Board may order and hear oral argument on the recommended findings, conclusions, decision, and order of the administrative law judge. A written request by a party must show good cause for oral argument and state reasons why arguments cannot be presented adequately in writing. A denial of a request for oral argument may be set forth in the NCUA Board's final decision. Oral argument before the NCUA Board must be on the record.

(c) *Final Decision of NCUA Board.* (1) Decisional employees may advise and assist the NCUA Board in the consideration and disposition of the case. The final decision of the NCUA Board will be based upon review of the entire record of the proceeding, except that the NCUA Board may limit the issues to be reviewed to those findings and conclusions to which opposing arguments or exceptions have been filed by the parties.

(2) The NCUA Board shall render a final decision within 90 days after notification of the parties that the case has been submitted for final decision, or 90 days after oral argument, whichever is later, unless the NCUA Board orders that the action or any aspect thereof be remanded to the administrative law judge for further proceedings. Copies of the final decision

and order of the NCUA Board shall be served upon each party to the proceeding, upon other persons required by statute, and, if directed by the NCUA Board or required by statute, upon any appropriate state or Federal supervisory authority.

§ 747.41 Stays Pending Judicial Review.

The commencement of proceedings for judicial review of a final decision and order of the NCUA Board may not, unless specifically ordered by the NCUA Board or a reviewing court, operate as a stay of any order issued by the NCUA Board. The NCUA Board may, in its discretion, and on such terms as it finds just, stay the effectiveness of all or any part of its order pending a final decision on a petition for review of that order.

Subpart B—Local Rules of Practice and Procedure

§ 747.100 Discovery Limitations.

(a) Parties to a proceeding set forth either at § 747.1 of Subpart A or in Subparts C, E or G of this Part may obtain discovery only through the production of documents. No other form of discovery shall be allowed.

(b) In the event that a person producing documents pursuant to a document subpoena is permitted to be deposed, all questioning shall be strictly limited to the identification of documents produced by that person and a reasonable examination to determine whether the subpoenaed person made an adequate search for, and has produced, all subpoenaed documents.

Subpart C—Local Rules and Procedures Applicable to Proceedings for the Involuntary Termination of Insured Status

§ 747.201 Scope.

Under the authority of Section 206(b) of the Act (12 U.S.C. § 1786(b)), the NCUA Board may terminate the insured status of an insured credit union upon the grounds set forth therein and enumerated in § 747.202. The procedure for terminating the insured status of an insured credit union as therein prescribed will be followed and hearings required thereunder will be conducted in accordance with the rules and procedures set forth in this Subpart and Subpart A of this Part. To the extent any rule or procedure of Subpart A is inconsistent with a rule or procedure prescribed in this Subpart C, Subpart C shall control.

§ 747.202 Grounds for Termination of Insurance.

The NCUA Board may institute proceedings to terminate the insured status of an insured credit union whenever it determines that an insured credit union is:

(a) Engaging or has engaged in unsafe or unsound practices in conducting its business;

(b) In an unsafe or unsound condition to continue as an insured credit union; or

(c) Violating or has violated any applicable law, rule, regulation, order, written condition imposed by the NCUA Board in response to any application or request of the credit union, or any written agreement entered into with the NCUA Board.

§ 747.203 Notice of Charges.

(a) Whenever the NCUA Board determines that grounds for termination of insured status exist, it will, for the purpose of securing correction of errant or illegal conditions, serve a Notice of Charges upon the concerned credit union. This Notice will contain a statement describing the unsafe or unsound practices, condition or the relevant violations.

(b) In the case of an insured state-chartered credit union, the NCUA Board shall send a copy of the Notice of Charges to the appropriate state authority, if any, having supervision over the credit union.

§ 747.204 Notice of Intention to Terminate Insured Status.

Unless correction of the practices, condition, or violations set forth in the Notice of Charges is made within 120 days after service of such statement, or within a shorter period of not less than 20 days after such service as the NCUA Board may require in any case where it determines that the insurance risk with respect to such credit union could be unduly jeopardized by further delay or as the appropriate state supervisory authority shall require in the case of an insured state-chartered credit union, the Board, if it determines to proceed further, shall give to the credit union not less than 30 days written notice of its intent to terminate the status of the credit union as an insured credit union. The notice shall contain a statement of the facts constituting the alleged un-

safe or unsound practices or condition or violations on which a hearing will be held. Such hearing shall commence not earlier than 30 days nor later than 60 days after the date of service of such notice upon the credit union, unless an earlier or later date is set by the NCUA Board at the request of the credit union.

§ 747.205 Order Terminating Insured Status.

If, upon the record of the hearing held pursuant to § 747.204, the NCUA Board finds that any unsafe or unsound practice or condition or violation specified in the notice has been established and has not been corrected within the time prescribed under § 747.204, the NCUA Board may issue and serve upon the credit union an order terminating its status as an insured credit union on a date subsequent to the date of such finding and subsequent to the expiration of the time specified in the notice.

§ 747.206 Consent to Termination of Insured Status.

Unless the credit union appears at the hearing designated in the notice of hearing by a duly authorized representative, it will be deemed to have consented to the termination of its status as an insured credit union. In the event the credit union fails to so appear at such hearing, the administrative law judge shall forthwith report the matter to the NCUA Board and the NCUA Board may thereupon issue an order terminating the credit union's insured status.

§ 747.207 Notice of Termination of Insured Status.

Prior to the effective date of the termination of the insured status of an insured credit union under Section 206(b) of the Act (12 U.S.C. § 1786(b)) and at such time as the Board shall specify, the credit union shall mail to each member at his or her last address of record on the books of the credit union, and publish in not less than two issues of a local newspaper of general circulation, notices of the termination of its insured status, and the credit union shall furnish the NCUA Board with proof of publication of such notice. The notice shall be as follows:

NOTICE

(Date)

1. The status of the _____ as an insured credit union under the provision of the Federal Credit Union Act, will terminate as of the close of business on the _____ day of _____;

2. Any deposits made by you after that date, either new deposits or additions to existing accounts, will not be insured by the National Credit Union Administration;

3. Accounts in the credit union on the _____ day of _____, _____, up to a maximum of $100,000 for each member, will continue to be insured, as provided by the Federal Credit Union Act, for one (1) year after the close of business on the _____ day of _____, _____; Provided, however, that any withdrawals after the close of business on the _____ day of _____, _____, will reduce the insurance coverage by the amount of such withdrawals.

(Name of Credit Union)

(Address)

§ 747.208 Duties after Termination.

(a) After the termination of the insured status of any credit union under Section 206(b) of the Act (12 U.S.C. § 1786(b)), insurance of its member accounts to the extent they were insured on the effective date of such termination, less any amounts thereafter withdrawn which reduce the accounts below the amount covered by insurance on the effective date of such termination, shall continue for a period of one year, but no shares issued by the credit union or deposits made after the date of such termination shall be insured by the NCUA Board.

(b) The credit union shall continue to pay premiums to the NCUA Board during such period and the Board shall have the right to examine the credit union from time to time during the period. The credit union shall, in all other respects, be subject to the duties and obligations of an insured credit union during the one year period. If the credit union is closed for liquidation within this period, the Board shall have the same powers and rights with respect to such credit union as in the case of an insured credit union.

Subpart D—Local Rules and Procedures Applicable to Suspensions and Prohibitions Where Felony Charged

§ 747.301 Scope.

The rules and procedures set forth in this Subpart are applicable to informal proceedings conducted by the NCUA Board, or a Presiding Officer designated by the Board, pursuant to Section 206(i) of the Act (12 U.S.C. § 1786(i)), to suspend, remove and/or prohibit from office or from further participation any institution-affiliated party of an insured credit union who:

(a) is charged in a state, Federal or territorial information or indictment or complaint with committing or participating in a crime involving dishonesty or breach of trust, which crime is punishable by imprisonment for a term exceeding one year under state or Federal law; or

(b) enters a pretrial diversion or other similar program as result of being charged in such information or indictment or complaint with participating or committing such crime; or

(c) is convicted of such crime.

Subpart A of this Part does not apply to proceedings under this Subpart.

§ 747.302 Rules of Practice; Remainder of Board of Directors.

Except as otherwise specifically provided in this Subpart, the following provisions shall apply to proceedings conducted under this Subpart:

(a)(1) *Power of attorney and notice of appearance.* Any person who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia may represent others before the NCUA Board or Presiding Officer designated by the NCUA Board upon filing with the NCUA Board a written declaration that he or she is currently qualified as provided by this paragraph, and is authorized to represent the particular party on whose behalf he acts. Any other person desiring to appear before or transact business with the NCUA Board in a representative capacity may be required to file with the NCUA Board a power of attorney showing his or her authority to act in such capacity, and he or she may be required to show to the satisfaction of the NCUA Board that he or she has the requisite qualifications. Attorneys and representatives of parties to proceedings shall file a written notice of appearance with the NCUA Board or with the Presiding Officer designated by the NCUA Board.

(2) *Summary suspension.* Contemptuous conduct by any person at an argument before the NCUA Board or at the hearing before a Presiding Officer shall be grounds for exclusion therefrom and suspension for the duration of the argument or hearing.

(b)(1) *Notice of hearing.* Whenever a hearing within the scope of this Subpart is ordered by the NCUA Board, a notice of hearing shall be given by the NCUA Board to the party afforded the hearing and to any appropriate state supervisory authority. The notice shall state the time, place, and nature of the hearing and the legal authority and jurisdiction under which the hearing is to be held, and shall contain a statement of the matters of fact or law constituting the grounds for the hearing. It shall be delivered by personal service, by registered or certified mail to the last known address, or by other appropriate means, not later than 30 nor earlier than 60 days before the hearing.

(2) *Party.* The term "party" means a person or agency named or admitted as a party, or any person or agency who has filed a written request and is entitled as of right to be admitted as a party; but a person or agency may be admitted for a limited purpose.

(c)(1) *Computation of time.* In computing any period of time prescribed or allowed by this Subpart, the date of the act, event or default from which the designated period of time begins to run is not to be included. The last day so computed shall be included, unless it is a Saturday, Sunday or legal holiday in the District of Columbia, in which event the period shall run until the end of the next day which is neither a Saturday, Sunday, nor such legal holiday. Intermediate Saturdays, Sundays, and legal holidays shall be included in the computation unless the time within which the act is to be performed is ten days or less in which event Saturdays, Sundays, and legal holidays shall not be included.

(2) *Service by mail.* Whenever any party has the right or is required to do some act or take some proceeding, within a period of time prescribed in this Subpart, after the service upon him of any document or other paper of any kind, and such service is made by mail, three days shall be added to the prescribed period from the date when the matter served is deposited in the U.S. mail.

(d) *Nonpublication of submissions.* Unless and until otherwise ordered by the NCUA Board, the notice of hearing, the transcript, written materials submitted during the hearing, the Presiding Officer's recommendation to the NCUA Board and any other papers filed in connection with a hearing under this Subpart, shall not be made public, and shall be for the confidential use only of the NCUA Board, the Presiding Officer, the parties and appropriate authorities.

(e) *Remainder of board of directors.* (1) If at any time, because of the suspension of one or more directors pursuant to this Subpart, there shall be on the board of directors of an insured credit union less than a quorum of directors not so suspended, all powers and functions vested in or exercisable by such board shall vest in and be exercisable by the director or directors on the board not so suspended, until such time as there shall be a quorum on the board of directors.

(2) In the event all of the directors of an insured credit union are suspended pursuant to this Subpart, the NCUA Board shall appoint persons to serve temporarily as directors in their place pending the termination of such suspensions, or until such time as those who have been suspended cease to be directors of the credit union and their respective successors have been elected by the members at an annual or special meeting and have taken office.

(3) Directors appointed temporarily by the NCUA Board pursuant to paragraph (e)(2) of this section, shall, within 30 days following their appointment, call a special meeting for the elec tion of new directors, unless during such 30-day period—

(i) the regular annual meeting is convened; or

(ii) the suspensions giving rise to the appointment of temporary directors are terminated.

§ 747.303 Notice of Suspension or Prohibition.

Whenever an institution-affiliated party of an insured credit union is charged in any state, Federal or territorial information or indictment or complaint with the commission of or participation in a crime involving dishonesty or breach of trust, which crime is punishable by imprisonment for a term exceeding one year under state or Federal law, the NCUA Board may, if continued service or participation by the concerned party may pose a threat to the interests of the credit union's members or may threaten to impair public confidence in the credit union, by written notice served upon such party, suspend him or her from office, or prohibit him or her from further participation in any manner in the affairs of the credit union, or both. A copy of the notice of suspension or prohibition shall also be served upon the credit union. This suspension or prohibition shall remain in effect until such information, indictment, or complaint is finally disposed of, or until such suspension or prohibition is terminated by the NCUA Board.

§ 747.304 Removal or Permanent Prohibition.

In the event that a judgment of conviction or an agreement to enter a pretrial diversion or other similar program is entered against the institution-affiliated party, and at such time as the judgment, if any, is not subject to further appellate review, the NCUA Board may, if continued service or participation by such party may pose a threat to the interests of the credit union's members or may threaten to impair public confidence in the credit

union, issue and serve upon the individual an order removing him or her from office or prohibiting him or her from further participation in any manner in the conduct of the affairs of the credit union except with the consent of the NCUA Board. A copy of such order will also be served upon such credit union. A finding of not guilty or other disposition of the charge will not preclude the NCUA Board from thereafter instituting proceedings, pursuant to the provisions of Section 206(g) of the Act (12 U.S.C. 1786(g)) and Subpart A of this Part, to remove such director, committee member, officer, or other person from office or to prohibit his or her further participation in the affairs of the credit union.

§ 747.305 Effectiveness of Suspension or Removal until Completion of Hearing.

Any notice of suspension or prohibition issued under § 747.303 and any order of removal or prohibition issued under § 747.304 will be effective upon service on the concerned party and will remain effective and outstanding until the completion of any hearing or appeal authorized under Section 206(i) of the Act (12 U.S.C. § 1786(i)) and this Subpart, unless such notice of suspension or order of removal is terminated by the NCUA Board.

§ 747.306 Notice of Opportunity for Hearing.

(a) Any notice of suspension or prohibition issued pursuant to § 747.303, and any order of removal or prohibition issued pursuant to § 747.404, shall be accompanied by a further notice to the concerned individual that he or she may, within 30 days of service of such notice, request in writing an informal hearing at which he or she may present evidence and argument that his or her continued service to or participation in the conduct of the affairs of the credit union does not, or is not likely to, pose a threat to the interests of the credit union's members or threaten to impair confidence in the credit union. Any notice of the opportunity for such a hearing shall be accompanied by a description of the hearing procedure and the criteria to be considered.

(b) A request for a hearing filed pursuant to paragraph (a) of this Section shall state with particularity the relief desired, the grounds therefor, and shall include, when available, supporting evidence. The request and supporting evidence shall be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

§ 747.307 Hearing.

(a) Upon receipt of a request for a hearing which complies with § 747.306, the NCUA Board will order an informal hearing to commence within the following 30 days in Washington, D.C. metropolitan area, or at such other place as the NCUA Board designates, before a Presiding Officer designated by the NCUA Board to conduct the hearing. At the request of the concerned party, the NCUA Board may order the hearing to commence at a time more than 30 days after the receipt of the request for such hearing.

(b) The notice of hearing shall be served by the NCUA Board upon the party or parties afforded the hearing and shall set forth the time and place of the hearing and the name and address of the Presiding Officer.

(c) The subject individual may appear at the hearing personally, through counsel, or personally with counsel. The individual shall have the right to introduce relevant and material written materials (or, at the discretion of the NCUA Board, oral testimony), and to present an oral argument before the Presiding Officer. A member of the enforcement staff of the Office of General Counsel of the NCUA may attend the hearing and may participate as a party. Neither the formal rules of evidence nor the adjudicative procedures of the Administrative Procedure Act (5 U.S.C. 554–557), nor Subpart A of this Part shall apply to the hearing. The proceedings shall be recorded and a transcript furnished to the individual upon request and after the payment of the cost thereof. The NCUA Board shall have the discretion to permit the presentation of witnesses, within specified time limits, so long as a list of such witnesses is furnished to the Presiding Officer at least ten days prior to the hearing. Witnesses shall not be sworn, unless specifically requested by either party or directed by the Presiding Officer. The Presiding Officer may examine any witness and each party shall have the opportunity to cross-examine any witness presented by an opposing party. Upon the request of either the subject individual or the representative of the Office of General Counsel, the record shall remain open for a period of five business days following the hearing, during which time the parties may make any addi-

tional submissions to the record. Thereafter, the record shall be closed.

(d) In the course of or in connection with any proceeding under this Subpart, the NCUA Board and the Presiding Officer will have the power to administer oaths and affirmations, to take or cause depositions to be taken, and to issue, revoke, quash, or modify subpoenas and subpoenas duces tecum. If the NCUA Board permits the presentation of witnesses, the NCUA Board or the Presiding Officer may require the attendance of witnesses from any place in any state or in any territory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. Witnesses subpoenaed shall be paid the same fees and mileage as are paid witnesses in the District Courts of the United States. The NCUA Board or the Presiding Officer may require the production of documents from any place in any such state, territory, or other place.

(e) The Presiding Officer will make his or her recommendations to the Board, where possible, within ten business days following the close of the record.

§ 747.308 Waiver of Hearing; Failure to Request Hearing or Review Based on Written Submissions; Failure to Appear.

(a) The subject individual may, in writing, waive an oral hearing and instead elect to have the matter determined by the NCUA Board on the basis of written submissions alone.

(b) Should any concerned party fail to request in writing an oral hearing or consideration based on written submissions alone within 30 days of service of the notice described in § 747.306, he or she will be deemed to have consented to the NCUA Board's action.

(c) Unless the concerned party appears at the hearing personally or by duly appointed representative, he or she will be deemed to have consented to the NCUA Board's action.

§ 747.309 Decision of the NCUA Board.

Within 60 days following the hearing, or receipt of the subject individual's written submissions where hearing has been waived pursuant to § 747.308, the NCUA Board shall notify the institution-affiliated party whether the suspension or prohibition will be continued, terminated, or otherwise modified, or whether the order of removal or prohibition will be rescinded or otherwise modified. Such notification shall contain a statement of the basis for the decision of the NCUA Board, if that decision is adverse to the respondent party. In the case of a decision favorable to the respondent on the subject of a prior order of removal or prohibition, the NCUA Board shall take prompt action to rescind or otherwise modify the order of removal or prohibition.

§ 747.310 Reconsideration by the NCUA Board.

(a) The subject individual shall have ten business days following receipt of the decision of the NCUA Board in which to petition the NCUA Board for initial reconsideration.

(b) The subject individual also shall be entitled to petition the NCUA Board for reconsideration of its decision any time after the expiration of a 12-month period from the date of the NCUA Board's decision, but no petition for reconsideration may be made within 12 months of a previous petition.

(c) Any petition shall state with particularity the basis for reconsideration, the relief sought, and any exceptions the individual has to the NCUA Board's findings. An individual's petition may be accompanied by a memorandum of points and authorities in support of his or her petition and any supporting documentation the individual may wish to have considered.

(d) No hearing need be granted on such petition for reconsideration. Promptly following receipt of the petition, the Board shall render its decision.

§ 747.311 Relevant Considerations.

In deciding the question of suspension, prohibition, or removal under this Subpart, the NCUA Board will consider the following:

(a) Whether the alleged offense is a crime which is punishable by imprisonment for a term exceeding one year under state or Federal law, and which involves dishonesty or breach of trust;

(b) Whether the continued presence of the subject individual in his or her position may pose a threat to the interests of the credit union's members because of the nature and extent of the individual's participation in the affairs of the insured credit union and/or the nature of the offense with

the commission of or participation in which the individual has been charged;

(c) Whether there is cause to believe that there may be an erosion of public confidence in the integrity, safety, or soundness of a particular credit union (either generally or in the particular locality in which the credit union is situated) if the subject individual is permitted to remain in his or her position in an insured credit union;

(d) Whether the individual is covered by the credit union's fidelity bond and, if so, whether the bond is likely to be revoked, or whether coverage under the bond will be affected adversely as a result of the information, indictment, complaint, judgment of conviction or entry into a pretrial diversion or other similar program; and

(e) The NCUA Board may consider any other factors which, in the specific case, appear relevant to the decision to continue in effect, rescind, terminate, or modify a suspension, prohibition, or removal order, except that it shall not consider the ultimate question of the guilt or innocence of the subject individual with regard to the crime with which he or she has been charged.

Subpart E—Local Rules and Procedures Applicable to Proceedings Relating to the Suspension or Revocation of Charters and to Involuntary Liquidations

§ 747.401 Scope.

The rules and procedures set forth in this subpart and Subpart A of this part are applicable to proceedings by the NCUA Board pursuant to section 120(b)(1) of the Act (12 U.S.C. § 1766(b)(1)) to suspend or revoke the charter of a solvent Federal credit union, and to place a solvent Federal credit union into involuntary liquidation. To the extent a rule or procedure set forth in Subpart A of this Part is inconsistent with a rule or procedure set forth in this Subpart E, Subpart E shall control.

§ 747.402 Grounds for Suspension or Revocation of Charter and for Involuntary Liquidation.

(a) *Grounds in general.* The NCUA Board may suspend or revoke the charter of any Federal credit union, and place such credit union into involuntary liquidation and appoint a liquidating agent therefor, upon its finding that the credit union has violated any provision of its charter or bylaws or of the Act or regulations issued thereunder.

(b) *Immediate suspension.* In any case where the Board determines that the grounds set forth in paragraph (a) of this section exist and that immediate action is necessary in order to prevent further dissipation of credit union assets or earnings, or further weakening of the credit union's condition, or to otherwise protect the interest of the credit union's insured members or the National Credit Union Share Insurance Fund, it may order without prior notice the immediate suspension of the charter of such credit union, and if the circumstances so warrant, may take possession of all books, records, assets, and property of every description of such credit union.

§ 747.403 Notice of Intent to Suspend or Revoke Charter; Notice of Suspension.

(a) Upon its determination that one or more of the grounds listed in § 747.402(a) exists, or that because of conditions described in § 747.402(b) immediate suspension of charter is necessary, the NCUA Board shall cause to be served upon that credit union a notice of intent to suspend or revoke charter and of intent to place into involuntary liquidation, or a notice of suspension. Such notice shall contain a statement of the facts which constitute the grounds for the action, a recitation of the options available to the credit union under paragraph (b) of this section, and an explanation of the results that will occur if the credit union fails to exercise said options.

(b) Not later than 40 days after the receipt of the notice provided for in paragraph (a) of this section, the Federal credit union may file with the NCUA Board a statement in writing setting forth the grounds and reasons why its charter should not be suspended or revoked and why it should not be placed into involuntary liquidation; or in lieu of a written statement, request an oral hearing which shall be conducted in accordance with the procedures set forth in this subpart. This statement or request shall be accompanied by a certified copy of a resolution of the board of directors of the Federal credit union concerned authorizing such statement or request, such certification to be made by the president and secretary of the board of directors.

(c) If the Federal credit union concerned does not exercise either alternative available in paragraph (b) of this section within the time required, it shall be deemed to have admitted the facts alleged in the notice and may be deemed to have consented to the relief sought.

§ 747.404 Notice of Hearing.

(a) Upon receipt of a request for hearing which complies with § 747.403(b), the NCUA Board shall transmit the request to the Office of Financial Institution Adjudication ("OFIA"). Such hearing shall commence no earlier than 30 days nor later than 60 days after the date the OFIA receives the request for a hearing, unless an earlier or later date is requested by the Federal credit union concerned and is granted by the NCUA Board in its discretion.

(b) Except as provided in § 747.405(b), the procedures of the Administrative Procedure Act (5 U.S.C. §§ 554–557) and Subpart A of this Part will apply to the hearing.

(c) Unless the Federal credit union shall appear at such hearing by a duly authorized representative, it shall be deemed to have consented to the suspension or revocation of its charter and to the placing of said credit union into involuntary liquidation.

§ 747.405 Issuance of Order.

(a) In the event of such consent as referred to in §§ 747.403(c) or 747.404(c), or if upon the record made at any such hearing as referred to in § 747.403(b), the NCUA Board finds that the charter of the Federal credit union concerned should be suspended or revoked and the credit union closed and placed into involuntary liquidation, it shall cause to be served on such credit union an order directing the suspension or revocation of its charter and directing that it be closed and placed into involuntary liquidation. Such order shall contain a statement of the findings upon which the order is based. Additionally, the NCUA Board shall appoint a liquidating agent or agents.

(b) The NCUA Board shall render its decision and cause such order to be served not later than 45 days after receipt either of consent or of written submissions, as the case may be, or in the case of a formal hearing, after service or the notice of submission referred to in § 747.40(a).

(c) Upon the receipt of a copy of the order which provides that the Federal credit union concerned be placed into involuntary liquidation, the officers and directors of that Federal credit union shall immediately deliver to the agent for the liquidating agent possession and control of all books, records, assets, and property of every description of the Federal credit union, and the agent for the liquidating agent shall proceed to convert said assets to cash, collect all debts due to said Federal credit union and to wind up its affairs in accordance with the provisions of the Act.

§ 747.406 Cancellation of Charter.

Upon the completion of the liquidation and certification by the agent for the liquidating agent that the distribution of the assets of the Federal credit union has been completed, the NCUA Board shall cancel the charter of the Federal credit union concerned.

Subpart F—Local Rules and Procedures Applicable to Proceedings Relating to the Termination of Membership in the Central Liquidity Facility [RESERVED]

Subpart G—Local Rules and Procedures Applicable to Recovery of Attorneys Fees and Other Expenses Under the Equal Access to Justice Act in NCUA Board Adjudications

§ 747.601 Purpose and Scope.

This Subpart contains the regulations of the NCUA implementing the Equal Access to Justice Act (5 U.S.C. § 504), as amended ("EAJA"). The EAJA provides for the award of attorneys fees and other expenses to eligible individuals and entities who are parties to proceedings conducted under this part. An eligible party may receive an award when it prevails over NCUA in a proceeding, or in a significant and discrete substantive portion of the proceeding, unless the position of the NCUA was substantially justified or special circumstances make an award unjust. The rules in this subpart describe the parties eligible for fee awards, explain how to apply for awards and the procedures and standards that NCUA will use to make them. To the extent a rule or procedure set

forth in Subpart A of this part is inconsistent with a rule or procedure set forth in this Subpart G, Subpart G will control.

§ 747.602 Eligibility of Applicants.

(a) To be eligible for an award of attorneys fees and expenses, an applicant must be a prevailing party in the proceeding for which it seeks an award and must be:

(1) An individual with a net worth of not more than $2 million;

(2) The sole owner of an unincorporated business who has a net worth of not more than $7 million, including both personal and business interests and not more than 500 employees at the time the proceeding was commenced (an applicant who owns an unincorporated business will be considered as an "individual" rather than a "sole owner of an unincorporated business" if the issues on which the applicant prevails are related primarily to personal interests rather than to business interests);

(3) A charitable or other tax-exempt organization described in Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)) with not more than 500 employees;

(4) A cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. § 1141j(a)) with not more than 500 employees; or

(5) Any other partnership, corporation, association, or public or private organization with a net worth of not more than $7 million and not more than 500 employees.

(b) For the purpose of determining eligibility, the net worth of an applicant and the number of employees of an applicant shall be determined as of the date the proceeding was initiated.

(c) The applicant's net worth includes the value of any assets disposed of for the purpose of meeting an eligibility standard and excludes any obligations incurred for this purpose. Transfers of assets or obligations incurred for less than reasonably equivalent value will be presumed to have been made for this purpose.

(d) The employees of an applicant include all persons who regularly perform services for remuneration for the applicant, under the applicant's direction and control; part-time employees shall be included on a proportional basis.

(e) The net worth and number of employees of the applicant and all of its affiliates shall be aggregated to determine eligibility. Any individual, corporation or other entity that directly or indirectly controls or owns a majority of the voting shares or other interest of the applicant, or any corporation or other entity of which the applicant directly or indirectly owns or controls a majority of the voting shares or other interest, will be considered an affiliate for purposes of this subpart, unless the NCUA Board determines that such treatment would be unjust and contrary to the purposes of the EAJA in light of the actual relationship between the affiliated entities. In addition, the NCUA Board may determine that financial relationships of the applicant other than those described in this paragraph constitute special circumstances that would make an award unjust.

(f) An applicant that participates in a proceeding primarily on behalf of one or more other persons or entities that would be ineligible is not itself eligible for an award.

§ 747.603 Prevailing Party.

An eligible applicant may be a "prevailing party" if the applicant wins an action after a full hearing or trial on the merits, if a settlement of the proceeding was effected on terms favorable to it, or if the proceeding against it has been dismissed. In appropriate situations an applicant may also have prevailed if the outcome of the proceeding has substantially vindicated the applicant's position on the significant, substantive matters at issue, even though the applicant has not totally avoided adverse final action.

§ 747.604 Standards for Award.

(a) A prevailing party may receive an award for fees and expenses incurred in connection with a proceeding, or in a significant and discrete substantive portion of the proceeding, by or against NCUA unless the position of NCUA during the proceeding was substantially justified. The burden of proving that an award should not be made is on counsel for NCUA. To avoid an award, counsel for NCUA must show that its position was reasonable in law and in fact.

(b) An award will be reduced or denied if the applicant has unduly or unreasonably protracted the proceeding or if special circumstances make the award sought unjust.

(c) Where an applicant has prevailed on one or more discrete substantive issues in a proceeding, even though all the issues were not resolved in its favor, any award shall be based on the fees

and expenses incurred in connection with the discrete significant, substantive issue or issues on which the applicant's position has been upheld. If such segregation of costs is not practicable, the award may be based on a fair proration of those fees and expenses incurred in the entire proceeding which would be recoverable under this section if proration were not performed.

(d) Whether separate or prorated treatment under the preceding paragraph, including the applicable proration percentage, is appropriate shall be determined on the facts of the particular case. Attention shall be given to the significance and nature of the respective issues and their separability and interrelationship.

§ 747.605 Allowable Fees and Expenses.

(a) Except as provided by § 747.604(b), awards will be based on rates customarily charged by persons engaged in the business of acting as attorneys, agents and expert witnesses, even if the services were made available without charge or at a reduced rate.

(b) No award under this subpart for the fee of an attorney or agent may exceed $75.00 per hour. No award to compensate an expert witness may exceed the highest rate at which NCUA is permitted to pay expert witnesses. However, an award may also include the reasonable expenses of the attorney, agent or witness as a separate item, if the attorney, agent or witness ordinarily charges clients separately for such expenses.

(c) In determining the reasonableness of the fee sought for an attorney, agent, or expert witness, the NCUA Board shall consider the following:

(1) If the attorney, agent, or expert witness is in private practice, his or her customary fee for like services, or, if he or she is an employee of the applicant, the fully allocated cost of the services;

(2) The prevailing rate for similar services in the community in which the attorney, agent, or expert witness ordinarily performs services;

(3) The time actually spent in the representation of the applicant; and

(4) Such other factors as may bear on the value of the services provided.

(d) The reasonable cost of any study, analysis, report, test, project, or similar matter prepared on behalf of the party may be awarded to the extent that the charge for the service does not exceed the prevailing rate for similar services, and the study or other matter was necessary for preparation of the applicant's case.

§ 747.606 Contents of Application.

(a) A prevailing eligible party, as defined in §§ 747.602, 747.603, and 747.604, seeking an award under this section, must file an application for an award of fees and expenses with the Secretary of the NCUA Board. The application shall include the following information:

(1) The identity of the applicant and the proceeding for which an award is sought;

(2) A showing that the applicant has prevailed and an identification of the issues in the proceeding on which the applicant believes that the position of NCUA was not substantially justified;

(3) A statement, with supporting documentation, that the applicant is an eligible party, as defined by § 747.602. If the applicant is an individual, he or she must state that his or her net worth does not exceed $2 million. If the applicant is not an individual, it shall state the number of its employees and that its net worth does not exceed $7 million as of the date the proceeding was initiated. However, an applicant may omit a statement of net worth if:

(i) It attaches a copy of a ruling by the Internal Revenue Service that it qualifies as an organization described in Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)) or, in the case of a tax-exempt organization not required to obtain a ruling from the Internal Revenue Service on its exempt status, a statement that describes the basis for the applicant's belief that it qualifies under such section; or

(ii) It states that it is a cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. § 1141j(a)).

(4) A statement of the amount of fees and expenses for which an award is sought; and

(5) Any other matters that the applicant believes may assist or wishes the NCUA Board to consider in determining whether and in what amount an award should be made.

(b) The application shall be signed by the applicant or an authorized officer or attorney of the applicant. It shall also contain or be accompanied by a written verification under oath or under penalty of perjury that the information provided in the application is true and correct.

(c) The application and documentation requirements of this subpart are required by law as a prerequisite to obtaining a benefit under the Equal Access to Justice Act and this subpart.

§ 747.607 Statement of Net Worth.

(a) Each applicant (other than a qualified tax-exempt organization or cooperative association) must provide a detailed statement showing the net worth of the applicant and any affiliates, as defined in § 747.602(a), when the proceeding was initiated. The exhibit may be in any form convenient to the applicant that provides full disclosure of the applicant's and its affiliates' assets and liabilities and is sufficient to determine whether the applicant is an eligible party. The administrative law judge or the NCUA Board may require additional information from the applicant to determine eligibility. Unless otherwise ordered by the Board or required by law, the statement shall be kept confidential and used by the NCUA Board only in making its determination of an award.

(b) If the applicant or any of its affiliates is a Federal credit union, the portion of the statement of net worth which relates to the Federal credit union shall consist of a copy of the Federal credit union's last Statement of Financial Condition filed before the initiation of the underlying proceeding.

(c) All statements of net worth shall describe any transfers of assets from or obligations incurred by the applicant or any affiliate, occurring in the six-month period prior to the date on which the proceeding was initiated, which reduced the net worth of the applicant and its affiliates below the applicable net worth ceiling. If there were none, the applicant shall so state.

§ 747.608 Documentation of Fees and Expenses.

The application shall be accompanied by full documentation of the fees and expenses, including the cost of any study, analysis, audit, test, project or similar matter, for which an award is sought. A separate, itemized statement shall be submitted for each professional firm or individual whose services are covered by the application, showing hours spent in connection with the proceeding by each individual, a description of the specific services performed, the rate at which each fee has been computed, any expenses for which reimbursement is sought, the total amount claimed, and the total amount paid or payable by the applicant or by any other person or entity for the services provided. The administrative law judge or the NCUA Board may require the applicant to provide vouchers, receipts, or other substantiation for any expenses claimed.

§ 747.609 Filing and Service of Applications.

(a) An application may be filed whenever the applicant has prevailed in the proceeding or in a significant and discrete substantive portion of the proceeding, but in no case later than 30 days after the Board's final disposition of the proceeding.

(b) If review or reconsideration is sought or taken of a decision on which an applicant believes it has prevailed, proceedings for the award of fees shall be stayed pending final disposition of the underlying controversy.

(c) As used in this subpart, final disposition means the issuance of a final order or any other final resolution of a proceeding, such as a settlement or voluntary dismissal.

(d) Any application for an award of fees and expenses shall be filed with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. Any application for an award and any other pleading or document related to an application, shall be filed and served on all parties to the proceeding in the same manner as other pleadings in the proceeding, except as provided in § 747.607(a) for statements of net worth.

§ 747.610 Answer to Application.

(a) Within 30 days after service of an application, counsel for NCUA may file an answer to the application. Unless counsel for NCUA requests and is granted an extension of time for filing or files a statement of intent to negotiate under paragraph (b) of this section, failure to file an answer within the 30-day period will be treated as a consent to the award requested.

(b) If counsel for NCUA and the applicant believe that the issues in the fee application can be settled, they may jointly file a statement of their intent to negotiate a settlement. The filing of this statement shall extend the time for filing an answer for an additional 30 days, and further extensions may be granted by the NCUA Board upon the joint request of counsel for NCUA and the applicant.

(c) The answer shall explain in detail any objections to the award requested and identify the facts relied on in support of counsel's position. If the answer is based on any alleged facts not already in the record of the proceeding, counsel shall include with the answer a request for further proceedings under § 747.613.

(d)(1) The applicant may file a reply if counsel for NCUA has addressed in his or her answer any of the following issues:

(i) That the position of NCUA in the proceeding was substantially justified;

(ii) That the applicant unduly protracted the proceedings; or

(iii) That special circumstances make an award unjust.

(2) The reply shall be filed within 15 days after service of the answer. If the reply is based on any alleged facts not already in the record of the proceeding, the applicant shall include with the reply a request for further proceedings under § 747.613.

§ 747.611 Comments by Other Parties.

Any party to a proceeding, other than the applicant and counsel for NCUA, may file comments on an application within 30 days after service of the application or on an answer within 15 days after service of the answer. A commenting party may not participate further in proceedings on the application unless the administrative law judge or the NCUA Board determines that the public interest requires such participation in order to permit full exploration of matters raised in the comments.

§ 747.612 Settlement.

The applicant and counsel for NCUA may agree on a proposed settlement of the award before final action on the application, either in connection with a settlement of the underlying proceeding, or after the underlying proceeding has been concluded, in accordance with NCUA's standard settlement procedure. If a prevailing party and counsel for NCUA agree on a proposed settlement of an award before an application has been filed, the application shall be filed with the proposed settlement.

§ 747.613 Further Proceedings.

(a) After the expiration of the time allowed for the filing of all documents necessary for the determination of a recommended fee award, the NCUA Board shall transmit the entire record to the administrative law judge who presided at the underlying proceeding. Ordinarily, the determination of an award will be made on the basis of the written record. However, on request of either the applicant or counsel for NCUA, or on its own initiative, the administrative law judge or the NCUA Board may order further proceedings, such as an informal conference, oral argument, additional written submissions or an evidentiary hearing. Such further proceedings shall be held only when necessary for full and fair resolution of the issues arising from the application, and shall be conducted as promptly as possible.

(b) A request that the administrative law judge or the NCUA Board order further proceedings under this section shall specifically identify the information sought or the disputed issues and shall explain why the additional proceedings are necessary to resolve the issues.

§ 747.614 Recommended Decision.

The administrative law judge shall file a recommended decision on the application with the NCUA Board within 60 days after completion of the proceedings on the application. The recommended decision shall include written findings and conclusions on the applicant's eligibility and status as a prevailing party, and an explanation of the reasons for any difference between the amount requested and the amount awarded. The recommended decision shall also include, if at issue, findings on whether NCUA's position was substantially justified, whether the applicant unduly protracted the proceedings, or whether special circumstances make an award unjust. If the applicant has sought an award against more than one agency, the recommended decision shall allocate responsibility for payment of any award made among the agencies, and shall explain the reasons for the allocation made. The administrative law judge shall file with and certify to the NCUA Board the record of the proceeding on the fee application, the recommended decision and proposed order. Promptly upon such filing, the NCUA Board shall serve upon each party to the proceeding a copy

of the administrative law judge's recommended decision, findings, conclusions and proposed order. The provisions of this section and § 747.613 shall not apply, however, in any case where the hearing was held before the NCUA Board.

§ 747.615 Decision of the NCUA Board.

Within 15 days after service of the recommended decision, findings, conclusions, and proposed order, the applicant or counsel for NCUA may file with the NCUA Board written exceptions thereto. A supporting brief may also be filed. The NCUA Board shall render its decision within 60 days after the matter is submitted to it. The NCUA Board shall furnish copies of its decision and order to the parties. Judicial review of the NCUA Board's final decision and order may be obtained as provided in 5 U.S.C. § 504(c)(2).

§ 747.616 Payment of Award.

An applicant seeking payment of an award granted by the NCUA Board shall submit to the NCUA's Office of the Controller a copy of the NCUA Board's Final Decision and Order granting the award, accompanied by a statement that it will not seek review of the decision and order in the United States court. All submissions shall be addressed to the Office of the Controller, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. The NCUA will pay the amount awarded within 60 days after receiving the applicant's statement, unless judicial review of the award or of the underlying decision of the adversary adjudication has been sought by the applicant or any other party to the proceeding.

Subpart H—Local Rules and Procedures Applicable to Investigations

§ 747.701 Applicability.

The rules in this Subpart apply only to informal and formal investigations conducted by the NCUA Board itself or its delegates. They do not apply to adjudicative or rulemaking proceedings or to routine, periodic or special examinations conducted by the NCUA Board's staff.

§ 747.702 Information Obtained in Investigations.

Information and documents obtained by the Board in the course of any investigation, unless made a matter of public record by the NCUA Board, shall be deemed non-public, but the NCUA Board approves the practice whereby the General Counsel may engage in, and may authorize any person acting on his or her behalf or at his or her direction to engage in, discussions with representatives of domestic or foreign governmental authorities, self-regulatory organizations, and with receivers, trustees, masters and special counsels or special agents appointed by and subject to the supervision of the courts of the United States, concerning information obtained in individual investigations, including investigations conducted pursuant to any order entered by the NCUA Board or its General Counsel pursuant to delegated authority.

§ 747.703 Authority to Conduct Investigations.

(a) The General Counsel and persons acting on his or her behalf and at his or her direction may conduct such investigations into the affairs of any insured credit union or institution-affiliated parties as deemed appropriate to determine whether such credit union or party has violated, is violating or is about to violate any provision of the Act, the NCUA Board's regulations or other relevant statutes or regulations that may bear on a party's fitness to participate in the affairs of a credit union. The General Counsel and persons acting on his or her behalf may investigate whether any party is unfit to participate in the affairs of a credit union, whether formal enforcement proceedings are warranted, or such other matters as the General Counsel or his or her designee, in his or her discretion, shall deem appropriate. Such investigations may be conducted either informally or formally.

(b) Formal investigations involve the exercise of the NCUA Board's subpoena power and are referred to here as formal investigative proceedings. In formal investigative proceedings, the General

Counsel and those to whom he or she delegates authority to act on his or her behalf and at his or her direction have augmented investigatory powers and need not rely on the powers available to them in informal investigations, and they may gather evidence through the issuance of subpoenas compelling the production of documents or testimony as well. In informal investigations evidence may be gathered ordinarily through the use of investigatory procedures or credit union examinations and through voluntary statements and submissions.

(c) The NCUA Board has delegated authority to the General Counsel, or designee thereof, to institute formal investigative proceedings by the entry of an order indicating the purpose of the investigation and the designation of persons to conduct that investigation on his or her behalf and at his or her direction. This delegation also extends to the NCUA Board's role as liquidator and conservator of insured credit unions. The power to issue a subpoena may not be delegated outside the agency. The General Counsel may amend such order as he deems appropriate.

Subpart I—Local Rules Applicable to Formal Investigative Proceedings

§ 747.801 Applicability.

The rules in this Subpart are applicable to a witness who is sworn in a formal investigative proceeding. Formal investigative proceedings may be held before the NCUA Board, before one or more of its members, or before any officer designated by the NCUA Board or its General Counsel, as described in Subpart H of this Part, and with or without the assistance of such other counsel as the NCUA Board deems appropriate, for the purpose of taking testimony of witnesses, conducting an investigation and receiving other evidence. The term "officer conducting the investigation" shall mean any of the foregoing.

§ 747.802 Non-public Formal Investigative Proceedings.

Unless otherwise ordered by the NCUA Board, all formal investigative proceedings shall be nonpublic.

§ 747.803 Subpoenas.

(a) Issuance. In the course of a formal investigative proceeding the officer conducting the investigation may issue a subpoena directing the party named therein to appear before the officer conducting the investigation at a specified time and place to testify or to produce documentary evidence, or both, relating to any matter under investigation.

(b) Service. Service of subpoenas shall be effected in the following manner:

(1) Service upon a natural party. Delivery of a copy of a subpoena to a natural person may be effected by—

(i) handing it to the person;

(ii) leaving it at his or her office with the person in charge thereof or, if there is no one in charge, by leaving it at a conspicuous place there;

(iii) leaving it at his or her dwelling place or usual place of abode with some person of suitable age and discretion who is found there; or

(iv) mailing it by registered or certified mail to him or her at his or her last known address. In the event that personal service as described in this paragraph is impracticable, any other method whereby actual notice is given to the respondent may be employed.

(2) Service upon other persons. When the person to be served is not a natural person, delivery of a copy of the subpoena may be effected by—

(i) handing it to a registered agent for service, or to any officer, director, or agent in charge of any office of such person;

(ii) mailing it by registered or certified mail to any such representative at his or her last known address; or

(iii) any other method whereby actual notice is given to any such representative.

(c) Witness fees and mileage. Witnesses appearing pursuant to subpoena shall be paid the same fees and mileage that are paid to witnesses in the United States district courts. Any such fees and mileage payments need be paid only upon submission of a properly completed application for reimbursement and in no event need they be paid sooner than 30 days after the appearance of the witness pursuant to subpoena.

(d) Enforcement. Whenever it appears to the General Counsel that any person upon whom a

subpoena was properly served pursuant to these Rules is refusing to fully comply with the terms of that subpoena, then the General Counsel, in his or her discretion, may apply to the courts of the United States for enforcement of such subpoena.

§ 747.804 Oath; False Statements.

At the discretion of the officer conducting the investigation, testimony of a witness may be taken under oath and administered by the officer. Any person making false statements under oath during the course of a formal investigative proceeding is subject to the criminal penalties for perjury in 18 U.S.C. 1621. Any person who knowingly and willfully makes false and fraudulent statements, whether under oath or otherwise, or who falsifies, conceals or covers up any material fact, or submits any false, fictitious or fraudulent information in connection with such a proceeding, is subject to the criminal penalties set forth in 18 U.S.C. 1001.

§ 747.805 Self-incrimination; Immunity.

(a) Self-incrimination. Except as provided in paragraph (b) of this section, a witness testifying or otherwise giving information in a formal investigative proceeding may refuse to answer questions on the basis of his or her right against self-incrimination granted by the Fifth Amendment of the Constitution of the United States.

(b) Immunity.

(1) No officer conducting any formal investigative proceeding (or any other informal investigation or examination) shall have the power to grant or promise any party any immunity from criminal prosecution under the laws of the United States or of any other jurisdiction.

(2) If the NCUA Board believes that the testimony or other information sought to be obtained from any party may be necessary to the public interest and that party has refused or is likely to refuse to testify or provide other information on the basis of his or her privilege against self-incrimination, the NCUA Board, with the approval of the Attorney General, may issue an order requiring the party to give testimony or provide other information that he or she has previously refused to provide on the basis of self-incrimination.

(3) Whenever a witness refuses, on the basis of his privilege against self-incrimination, to testify or provide other information in a formal investigative proceeding, and the officer conducting the investigation communicates to that person an order of the NCUA Board requiring him or her to testify or provide other information, the witness may not refuse to comply with the order on the basis of his or her privilege against self-incrimination; but no testimony or other information compelled under the order (or any information directly or indirectly derived from such testimony or other information) may be used against the witness in any criminal case, except a prosecution for perjury, giving a false statement, or otherwise failing to comply with the order.

§ 747.806 Transcripts.

Transcripts, if any, of formal investigative proceedings shall be recorded solely by the official reporter, or by any other person or means designated by the officer conducting the investigation. A party who has submitted documentary evidence or testimony in a formal investigative proceeding shall be entitled, upon written request, to procure a copy of his or her documentary evidence or a transcript of his or her testimony on payment of the appropriate fees; provided, however, that in a non-public formal investigative proceeding the NCUA Board may for good cause deny such request or the NCUA Board may place reasonable limitations upon the use of the documentary evidence and transcript. In any event, any witness, upon proper identification, shall have the right to inspect the official transcript of the witness's own testimony.

§ 747.807 Rights of Witnesses.

(a) In the event that a formal investigative proceeding is conducted pursuant to a specific order entered by the NCUA Board or by its General Counsel, then any party who is compelled or requested to provide documentary evidence or testimony as part of such proceeding shall, upon request, be shown a copy of the NCUA Board's or its delegate's order. Copies of such orders shall not be provided for their retention to such persons requesting same except in the sole discretion of the General Counsel or his designee.

(b) Any party compelled to appear, or who appears by request or permission of the officer conducting the investigation, in person at a formal investigative proceeding may be accompanied,

represented and advised by counsel who is a member of the bar of the highest court of any state; provided however, that all witnesses in such proceeding shall be sequestered, and unless permitted in the discretion of the officer conducting the investigation, no witness or the counsel accompanying any such witness shall be permitted to be present during the examination of any other witness called in such proceeding.

(c)(1) The right of a witness to be accompanied, represented and advised by counsel shall mean the right to have an attorney present during any formal investigative proceeding and to have the attorney—

(i) advise such person before, during and after such testimony;

(ii) question such person briefly at the conclusion of his testimony to clarify any answers such person has given; and

(iii) make summary notes during such testimony solely for the use of such person.

(2) From time to time, in the discretion of the officer, it shall be necessary for persons other than the witness and his or her counsel to attend nonpublic investigative proceedings. For example, the officer may deem it appropriate that outside counsel to the NCUA Board attend and advise him or her concerning the proceeding including the examination of a particular witness. In these circumstances, outside counsel would not be an officer as that term is used. In other circumstances, it may be appropriate that a technical expert (such as an accountant) accompany the witness and his or her counsel in order to assist counsel in understanding technical issues. These latter circumstances should be rare, are left to the discretion of the officer conducting the investigation, and shall not in any event be allowed to serve as a ruse to coordinate testimony between witnesses, to oversee or supervise the testimony of any witness, or otherwise defeat the beneficial effects of the witness sequestration rule.

(d) The officer conducting the investigation may report to the NCUA Board any instances where any witness or counsel has been guilty of dilatory, obstructionist or contumacious conduct during the course of a formal investigative proceeding or any other instance of violations of these rules. The NCUA Board will thereupon take such further action as the circumstance may warrant including barring the offending person from further participation in the particular formal investigative proceeding or even from further practice before the Board.

Subpart J—Local Procedures and Standards Applicable to a Notice of Change in Senior Executive Officers, Directors or Committee Members Pursuant to Section 212 of the Act

§ 747.901 Scope.

The rules and procedures set forth in this Subpart shall apply to the notice filed by a credit union pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter, for the consent of the NCUA to add to or replace an individual on the board of directors or supervisory or credit committee, or to employ any individual as a senior executive officer or change the responsibilities of any individual to a position of senior executive officer where the credit union either has been chartered less than 2 years; or is in "troubled condition," as defined in § 701.14 of this Chapter. Subpart A of this Part shall not apply to any proceeding under this Subpart.

§ 747.902 Grounds for Disapproval of Notice.

The NCUA Board or its designee may issue a notice of disapproval with respect to a notice submitted by a credit union pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter, where the competence, experience, character, or integrity of the individual with respect to whom such notice is submitted indicates that it would not be in the best interest of the members of the credit union or the public to permit the individual to be employed by or associated with, such credit union.

§ 747.903 Procedures Where Notice of Disapproval Issued; Reconsideration.

(a) The notice of disapproval shall be served upon the federally insured credit union and the candidate for director, committee member or senior executive officer. The notice of disapproval shall:

(1) Summarize or cite the relevant consideration specified in § 747.902;

(2) Inform the individual and the credit union that, within 15 days of receipt of the notice of disapproval, they can request

reconsideration by the Regional Director of the initial determination, or can appeal the determination directly to the NCUA Board;

(3) Specify what additional information, if any, must be considered in the reconsideration.

(b) The request for reconsideration by the Regional Director must be filed at the appropriate Regional Office.

(c) The Regional Director shall act on a request for reconsideration within 30 days of its receipt.

§ 747.904 Appeal.

(a) Time for filing. Within 15 days after issuance of a Notice of Disapproval or a determination on a request for reconsideration by the Regional Director, the individual or credit union (henceforth petitioner) may appeal by filing with the NCUA Board a written request for appeal.

(b) Contents of request. Any appeal must be in writing and include:

(1) The reasons why the NCUA Board should review the disapproval; and

(2) Relevant, substantive and material facts that for good cause were not previously set forth in the notice required to be filed pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter.

(c) Procedures for review of request. Within 30 days of the NCUA Board's receipt of an appeal, the NCUA Board may request in writing that the petitioner submit additional facts and records to support the appeal. The petitioner shall have 15 days from the date of issuance of such written request to provide such additional information. Failure by the petitioner to provide additional information may, as determined solely by the NCUA Board or its designee, result in denial of the petitioner's appeal.

(d) Determination on appeal by NCUA Board or its designee.

(1) Within 90 days from the date of the receipt of an appeal by the NCUA Board or its designee or of its receipt of additional information requested under paragraph (c) of this Section, the NCUA Board or its designee shall notify the petitioner whether the disapproval will be continued, terminated, or otherwise modified. The NCUA Board or its designee shall promptly rescind or modify the notice of disapproval where the decision is favorable to the petitioner.

(2) The determination by the NCUA Board on the appeal shall be provided to the petitioner in writing, stating the basis for any decision of the NCUA Board or its designee that is adverse to the petitioner, and shall constitute a final order of the NCUA Board.

(3) Failure by the NCUA Board to issue a determination on the petitioner's appeal within the 90-day period prescribed under paragraph (d)(1) of this Section shall be deemed a denial of the appeal for purpose of § 747.905.

§ 747.905 Judicial Review.

(a) Failure to file an appeal within the applicable time periods, either to the initial determination or to the decision on request for reconsideration, shall constitute a failure by the petitioner to exhaust available administrative remedies and, due to such failure, any objections to the initial determination or request for reconsideration shall be deemed to be waived and such determination shall be deemed to have been accepted by, and shall be binding upon, the petitioner.

(b) For purposes of seeking judicial review of actions taken pursuant to this Section, suit may be filed in the United States District Court for the district where the requester resides, for the district where the credit union's principal place of business is located, or for the District of Columbia.

Subpart K—Inflation Adjustment of Civil Monetary Penalties

§ 747.1001 Adjustment of civil money penalties by the rate of inflation pursuant to section 31001(s) of the Debt Collection Improvement Act of 1996 (Public Law 104–134, 110 Stat. 1321–358 (28 U.S.C. 2461 note)).

(a) A first tier civil money penalty imposed pursuant to 12 U.S.C. 1786(k)(2)(A), for a violation occurring after October 23, 1996, shall not exceed $5,500 per day for each day the violation continues.

(b) A second tier civil money penalty imposed pursuant to 12 U.S.C. 1786(k)(2)(B), for a violation, practice or breach occurring after October 23, 1996, shall not exceed $27,500 per day for each day the violation, practice or breach continues.

(c) A third tier civil money penalty imposed pursuant to 12 U.S.C. 1786(k)(2)(C) upon any person

other than an insured credit union, for a violation, practice or breach occurring after October 23, 1996, shall not exceed $1,100,000 per day for each day the violation, practice or breach continues.

(d) A third tier civil money penalty imposed pursuant to 12 U.S.C. 1786(k)(2)(C) upon an insured credit union, for a violation, practice or breach occurring after October 23, 1996, shall not exceed the lesser of—

(1) $1,100,000 per day for each day the violation, practice or breach continues; or

(2) 1 percent of the total assets of such credit union for each day the violation, practice or breach continues.

Part 748

Report of Crime or Catastrophic Act and Bank Secrecy Act Compliance

§ 748.0 Security program.

(a) Each federally-insured credit union will develop a written security program within 90 days of the effective date of insurance.

(b) The security program will be designed to protect each credit union office from robberies, burglaries, larcenies and embezzlement; to prevent destruction of vital records as defined in the *Accounting Manual for Federal Credit Unions;* and to assist in the identification of persons who commit or attempt such crimes.

§ 748.1 Filing of reports.

(a) *Compliance Report.* Each federally-insured credit union shall file with the regional director an annual statement certifying its compliance with the requirements of this Part. The statement shall be dated and signed by the president or other managing officer of the credit union. The statement is contained on the Report of Officials which is submitted annually by federally-insured credit unions after the election of officials. In the case of federally-insured state-chartered credit unions, this statement can be mailed to the regional director via the state supervisory authority, if desired. In any event, a copy of the statement shall always be sent to the appropriate state supervisory authority.

(b) *Catastrophic Act Report.* Each federally-insured credit union will notify the regional director within 5 business days of any catastrophic act that occurs at its office(s). A catastrophic act is any natural disaster such as a flood, tornado, earthquake, etc., or major fire or other disaster resulting in some physical destruction or damage to the credit union. Within a reasonable time after a catastrophic act occurs, the credit union shall ensure that a record of the incident is prepared and filed at its main office. In the preparation of such record, the credit union should include information sufficient to indicate the office where the catastrophic act occurred; when it took place; the amount of the loss, if any; whether any operational or mechanical deficiency(ies) might have contributed to the catastrophic act; and what has been done or is planned to be done to correct the deficiency(ies).

(c) *Suspicious Activity Report.* (1) Each federally-insured credit union will report any crime or suspected crime that occurs at its office(s), utilizing NCUA Form 2382, Suspicious Activity Report (SAR), within thirty calendar days after discovery. Each federally-insured credit union must follow the instructions and reporting requirements accompanying the SAR. Copies of the SAR may be obtained from the appropriate NCUA Regional Office.

(2) Each federally-insured credit union shall maintain a copy of any SAR that it files and the original of all attachments to the report for a period of five years from the date of the report, unless the credit union is informed in writing by the National Credit Union Administration that the materials may be discarded sooner.

(3) Failure to file a SAR in accordance with the instructions accompanying the report may subject the federally-insured credit union, its officers, directors, agents or other institution-affiliated parties to the assessment of civil money penalties or other administrative actions.

(4) Filing of Suspicious Activity Reports will ensure that law enforcement agencies and NCUA are promptly notified of actual or suspected crimes. Information contained on SARs will be entered into an interagency database and will assist the federal government in taking appropriate action.

§ 748.2 Bank Secrecy Act compliance programs and procedures.

(a) *Purpose.* This Section is issued to ensure that all federally-insured credit unions establish and maintain procedures reasonably designed to assure and monitor compliance with the requirements of Subchapter II of Chapter 53 of Title 31, United States Code, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, and the implementing regulations promulgated thereunder by the Department of Treasury, 31 C.F.R. Part 103.

(b) *Compliance Procedures.* On or before August 1, 1987, each federally-insured credit union shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with recordkeeping and reporting requirements set forth in Subchapter II of Chapter 53 of title 31, United States Code, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act and the implementing regulations promulgated thereunder by the Department of Treasury, 31 C.F.R. Part 103. This program shall be reduced to writing, approved by the board of directors of the institution, and noted in the minutes.

(c) *Contents of Compliance Program.* Such compliance program shall at a minimum—

(1) Provide for a system of internal controls to assure ongoing compliance;

(2) Provide for independent testing for compliance to be conducted by credit union personnel or outside parties;

(3) Designate an individual responsible for coordinating and monitoring day-to-day compliance; and

(4) Provide training for appropriate personnel.

Part 749

Records Preservation Program

§ 749.0 Records Preservation.

All federally insured credit unions must maintain a records preservation program to identify, store and reconstruct vital records in the event that the credit union's records are destroyed.

§ 749.1 Implementation.

The Financial Officer of the credit union is responsible for storing duplicate vital records at a vital records center. This responsibility may be delegated.

(a) The Records Preservation Program must be operational within 6 months after the credit union's insurance certificate is issued.

(b) The vital records center is defined as any location far enough from the credit union's office to avoid the simultaneous loss of both sets of records in the event of disaster.

(c) Records must be stored every 3 months, within 30 days after the end of the 3 month period. Previously stored records may be destroyed when the current records are stored.

(d) A records preservation log will be maintained showing what records were stored, where the records were stored, when the records were stored, and who sent the records for storage.

(e) Stored records may be in any format which can he used to reconstruct the credit union's records. Formats include paper originals, machine copies, micro film or fiche, magnetic tape, etc.

(f) Credit unions which have some or all of their records maintained by an off-site data processor are considered to be in compliance for the storage of those records.

§ 749.2 Vital Records To Be Stored.

At least the following records, as of the most recent month end, must be stored:

(a) A list of share and/or deposit and loan balances for each member's account.

(1) The list of balances will be individually identified by a name or number.

(2) Multiple loans of one account will be listed separately.

(3) Information sufficient to enable the credit union to locate each member, such as address and telephone number, shall also be included, unless the board of directors determines that such information is readily available from another source.

(b) A financial report which lists all of the credit union's asset and liability accounts.

(c) A list of the credit union's banks, insurance policies and investments. This information may be marked "permanent" and be updated only when changes are made.

Part 760

Loans in Areas Having Special Flood Hazards

§ 760.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued pursuant to 12 U.S.C. 1757, 1789 and 42 U.S.C. 4012a, 4104a, 4104b, 4106, 4128.

(b) *Purpose.* The purpose of this part is to implement the requirements of the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129).

(c) *Scope.* This part, except for §§ 760.6 and 760.8, applies to loans secured by buildings or mobile homes located or to be located in areas determined by the Director of the Federal Emergency Management Agency to have special flood hazards. Sections 760.6 and 760.8 apply to loans secured by buildings or mobile homes, regardless of location.

§ 760.2 Definitions.

(a) *Act* means the National Flood Insurance Act of 1968, as amended (42 U.S.C. 4001–4129).

(b) *Credit union* means a Federal or State-chartered credit union that is insured by the National Credit Union Share Insurance Fund.

(c) *Building* means a walled and roofed structure, other than a gas or liquid storage tank, that is principally above ground and affixed to a permanent site, and a walled and roofed structure while in the course of construction, alteration, or repair.

(d) *Community* means a State or a political subdivision of a State that has zoning and building code jurisdiction over a particular area having special flood hazards.

(e) *Designated loan* means a loan secured by a building or mobile home that is located or to be located in a special flood hazard area in which flood insurance is available under the Act.

(f) *Director of FEMA* means the Director of the Federal Emergency Management Agency.

(g) *Mobile home* means a structure, transportable in one or more sections, that is built on a permanent chassis and designed for use with or without a permanent foundation when attached to the required utilities. The term *mobile home* does not include a recreational vehicle. For purposes of this part, the term *mobile home* means a mobile home on a permanent foundation. The term *mobile home* means a manufactured home as that term is used in the NFIP.

(h) *NFIP* means the National Flood Insurance Program authorized under the Act.

(i) *Residential improved real estate* means real estate upon which a home or other residential building is located or to be located.

(j) *Servicer* means the person responsible for:

(1) Receiving any scheduled, periodic payments from a borrower under the terms of a loan, including amounts for taxes, insurance premiums, and other charges with respect to the property securing the loan; and

(2) Making payments of principal and interest and any other payments from the amounts received from the borrower as may be required under the terms of the loan.

(k) *Special flood hazard area* means the land in the flood plain within a community having at least a one percent chance of flooding in any given year, as designated by the Director of FEMA.

(l) *Table funding* means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds.

§ 760.3 Requirement to purchase flood insurance where available.

(a) *In general.* A credit union shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the Act. Flood insurance coverage under the Act is limited to the overall value of the property securing the designated loan minus the value of the land on which the property is located.

(b) *Table funded loan.* A credit union that acquires a loan from a mortgage broker or other entity through table funding shall be considered to be making a loan for the purposes of this part.

§ 760.4 Exemptions.

The flood insurance requirement prescribed by § 760.3 does not apply with respect to:

(a) Any State-owned property covered under a policy of self-insurance satisfactory to the Director of FEMA, who publishes and periodically revises the list of States falling within this exemption; or

(b) Property securing any loan with an original principal balance of $5,000 or less and a repayment term of one year or less.

§ 760.5 Escrow requirement.

If a credit union requires the escrow of taxes, insurance premiums, fees, or any other charges for a loan secured by *residential* improved real estate or a mobile home that is made, increased, extended, or renewed on or after November 1, 1996, the credit union shall also require the escrow of all premiums and fees for any flood insurance required under § 760.3. The credit union, or a servicer acting on behalf of the credit union, shall deposit the flood insurance premiums on behalf of the borrower in an escrow account. This escrow account will be subject to escrow requirements adopted pursuant to section 10 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2609) (RESPA), which generally limits the amount that may be maintained in escrow accounts for certain types of loans and requires escrow account statements for those accounts, only if the loan is otherwise subject to RESPA. Following receipt of a notice from the Director of FEMA or other provider of flood insurance that premiums are due, the credit union, or a servicer acting on behalf of the credit union, shall pay the amount owed to the insurance provider from the escrow account by the date when such premiums are due.

§ 760.6 Required use of standard flood hazard determination form.

(a) *Use of form.* A credit union shall use the standard flood hazard determination form developed by the Director (as set forth in Appendix A of 44 CFR part 65) when determining whether the building or mobile home offered as collateral security for a loan is or will be located in a special flood hazard area in which flood insurance is available under the Act. The standard flood hazard determination form may be used in a printed, computerized, or electronic manner.

(b) *Retention of form.* A credit union shall retain a copy of the completed standard flood hazard determination form, in either hard copy or electronic form, for the period of time the credit union owns the loan.

§ 760.7 Forced placement of flood insurance.

If a credit union, or a servicer acting on behalf of the credit union, determines, at any time during the term of a designated loan that the building or mobile home and any personal property securing the designated loan is not covered by flood insurance or is covered by flood insurance in an amount less than the amount required under § 760.3, then the credit union or its servicer shall notify the borrower that the borrower should obtain flood insurance, at the borrower's expense, in an amount at least equal to the amount required under § 760.3, for the remaining term of the loan. If the borrower fails to obtain flood insurance within 45 days after notification, then the credit union or its servicer shall purchase insurance on the borrower's behalf. The credit union or its servicer may charge the borrower for the cost of premiums and fees incurred in purchasing the insurance.

§ 760.8 Determination fees.

(a) *General.* Notwithstanding any Federal or State law other than the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4001–4129), any credit union, or a servicer acting on behalf of the credit union, may charge a reasonable fee for determining whether the building or mobile home securing the loan is located or will be located in a special flood hazard area. A determination fee may also include, but is not limited to, a fee for life-of-loan monitoring.

(b) *Borrower fee.* The determination fee authorized by paragraph (a) of this section may be charged to the borrower if the determination:

(1) Is made in connection with a making, increasing, extending, or renewing of the loan that is initiated by the borrower;

(2) Reflects the Director of FEMA's revision or updating of floodplain areas or flood-risk zones;

(3) Reflects the Director of FEMA's publication of a notice or compendium that:

(i) Affects the area in which the building or mobile home securing the loan is located; or

(ii) By determination of the Director of FEMA, may reasonably require a determination whether the building or mobile home securing the loan is located in a special flood hazard area; or

(4) Results in the purchase of flood insurance coverage by the credit union or its servicer on behalf of the borrower under § 760.7.

(c) *Purchaser or transferee fee.* The determination fee authorized by paragraph (a) of this section may be charged to the purchaser or transferee of a loan in the case of the sale or transfer of the loan.

§ 760.9 Notice of special flood hazards and availability of Federal disaster relief assistance.

(a) *Notice requirement.* When a credit union makes, increases, extends, or renews a loan secured by a building or a mobile home located or to be located in a special flood hazard area, the credit union shall mail or deliver a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan.

(b) *Contents of notice.* The written notice must include the following information:

(1) A warning, in a form approved by the Director of FEMA, that the building or the mobile home is or will be located in a special flood hazard area;

(2) A description of the flood insurance purchase requirements set forth in section 102(b) of the Flood Disaster Protection Act of 1973, as amended (42 U.S.C. 4012a(b));

(3) A statement, where applicable, that flood insurance coverage is available under the NFIP and may also be available from private insurers; and

(4) A statement whether Federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a Federally-declared disaster.

(c) *Timing of notice.* The credit union shall provide the notice required by paragraph (a) of this section to the borrower within a reasonable time before the completion of the transaction and to the servicer as promptly as practicable after the credit union provides notice to the borrower and in any event no later than the time the credit union provides other similar notices to the servicer concerning hazard insurance and taxes. Notice to the servicer may be made electronically or may take the form of a copy of the notice to the borrower.

(d) *Record of receipt.* The credit union shall retain a record of the receipt of the notices by the borrower and the servicer for the period of time the credit union owns the loan.

(e) *Alternate method of notice.* Instead of providing the notice to the borrower required by paragraph (a) of this section, a credit union may obtain satisfactory written assurance from a seller or lessor that, within a reasonable time before the completion of the sale or lease transaction, the seller or lessor has provided such notice to the purchaser or lessee. The credit union shall retain a record of the written assurance from the seller or lessor for the period of time the credit union owns the loan.

(f) *Use of prescribed form of notice.* A credit union will be considered to be in compliance with the requirement for notice to the borrower of this section providing written notice to the borrower containing the language presented in the appendix to this part within a reasonable time before the completion of the transaction. The notice presented in the appendix to this part satisfies the borrower notice requirements of the Act.

§ 760.10 Notice of servicer's identity.

(a) *Notice requirement.* When a credit union makes, increases, extends, renews, sells, or transfers a loan secured by a building or mobile home located or to be located in a special flood hazard area, the credit union shall notify the Director of FEMA (or the Director's designee) in writing of the identity of the servicer of the loan. The Director of FEMA has designated the insurance provider to receive the credit union's notice of the servicer's identity. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee.

(b) *Transfer of servicing rights.* The credit union shall notify the Director of FEMA (or the Director's

designee) of any change in the servicer of a loan described in paragraph (a) of this section within 60 days after the effective date of the change. This notice may be provided electronically if electronic transmission is satisfactory to the Director of FEMA's designee. Upon any change in the servicing of a loan described in paragraph (a) of this section, the duty to provide notice under this paragraph (b) shall transfer to the transferee servicer.

Appendix to Part 760—Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Director of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's *Flood Insurance Rate Map* or the *Flood Hazard Boundary Map* for the following community: _____. This area has at least a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard area is 26 percent (26%).

Federal law allows a lender and borrower jointly to request the Director of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

_____ The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

- Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP. Flood insurance also may be available from private insurers that do not participate in the NFIP.
- At a minimum, flood insurance purchased must cover *the lesser of*:

(1) the outstanding principal balance of the loan; *or*

(2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the overall value of the property securing the loan minus the value of the land on which the property is located.

- Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

_____ Flood insurance coverage under the NFIP is not available for the property securing the loan because the community in which the property is located does not participate in the NFIP. In addition, if the non-participating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally-declared flood disaster.

Part 790

Description of NCUA; Requests for Agency Action.

§ 790.1 Scope.

This Part contains a description of NCUA's organization and the procedures for public requests for action by the Board. Part 790 pertains to the practices of the National Credit Union Administration (NCUA) only and does not apply to credit union operations.

§ 790.2 Central and Regional Office Organization.

(a) *General organization.* NCUA is composed of the Board with a Central Office in Alexandria, Virginia, six Regional Offices, the Asset Liquidation Management Center, the Community Development Revolving Loan Program, and the NCUA Central Liquidity Facility (CLF).

(b) *Central Office.* The Central Office address is NCUA, 1775 Duke St., Alexandria, Virginia 22314–3428.

(1) *The NCUA Board.* NCUA is managed by its Board. The Board consists of three members appointed by the President, with the advice and consent of the Senate, for six-year terms. One Board member is designated by the President to be Chairman of the Board. A second member is designated by the Board to be Vice-Chairman. The Board is also responsible for management of the National Credit Union Share Insurance Fund (NCUSIF) and serves as the Board of Directors of the CLF. The Chairman shall be the spokesman for the Board and shall represent the Board and the NCUA in its official relations with other branches of the government.

(2) *Secretary of the Board.* The Secretary of the Board is responsible for the secretarial functions of the Board. The Secretary's responsibilities include preparing agendas for meetings of the Board, preparing and maintaining the minutes for all official actions taken by the Board, and executing and maintaining all documents adopted by the Board or under its direction. The Secretary also serves as the Secretary of the CLF.

(3) *Office of Administration.* The Director of the Office of Administration is responsible for providing NCUA's executive offices and Regional Directors with administrative services generally, including: Agency security; information resources management, contracting and procurement; contract management; management of equipment and supplies; acquisition; records management; printing and graphics; and warehousing and distribution. The Director is also responsible for carrying out the Board's responsibilities under the Privacy Act, the Paperwork Reduction Act, and in directing NCUA responses to reporting requirements.

(4) *Asset Management and Assistance Center.* The President of the Asset Management and Assistance Center (AMAC) is responsible for monitoring, evaluating, disposing, and/or managing major assets acquired by NCUA; responsible for managing involuntary liquidations for all federally insured credit unions placed into involuntary liquidation including the orderly processing of payments of share insurance, sale and/or collection of loan portfolios, liquidation of other assets and achieving other recoveries, payments to creditors, and distributions to any uninsured shareholders. The President, AMAC, serves as a primary consultant with the regional offices on asset sales or purchases to restructure problem case credit unions, as technical expert to evaluate specific areas of credit union operations, and as instructor in training classes; responsible to prepare and negotiate bond claims; responsible to manage or assist in the management of conservatorships. The address of AMAC is 4807 Spicewood Springs Road, Suite 5100, Austin, Texas 78759–8490.

(5) *Office of Chief Financial Officer.* NCUA's chief financial officer is in charge of budgetary, accounting and financial matters for the NCUA, including responsibility for submitting annual budget and staffing requests for approval by the Board and, as required, by the Office of Management and Budget; for managing NCUA's budgetary resources; for managing the operations of the National Credit Union Share Insurance Fund (NCUSIF) to include accounting, financial reporting and the collection and payment of capitalization deposits, insurance

premiums and insurance dividends; for collecting annual operating fees from federal credit unions, for maintaining NCUA's accounting system and accounting records; for processing payroll, travel, and accounts payable disbursements; and for preparing internal and external financial reports.

(6) *Office of Examination and Insurance.*

(i) The Director of the Office of Examination and Insurance: Formulates standards and procedures for examination and supervision of the community of federally insured credit unions, and reports to the Board on the performance of the examination program; manages the risk to the NCUSIF, to include overseeing the NCUSIF Investment Committee, monitoring the adequacy of NCUSIF reserves, analyzing the reasons for NCUSIF losses, formulating policies and procedures regarding the supervision of financially troubled credit unions, and evaluating certain requests for special assistance pursuant to Section 208 of the Federal Credit Union Act and for certain proposed administrative actions regarding federally-insured credit unions; serves as the Board expert on accounting principles and standards and on auditing standards; represents NCUA at meetings with the American Institute of Certified Public Accountants (AICPA), Federal Financial Institutions Examination Council (FFIEC) and General Accounting Office (GAO); and collects data and provides statistical reports. The Director is also responsible for developing and conducting research in support of NCUA programs, and for preparing reports on research activities for the information and use of agency staff, credit union officials, state credit union supervisory authorities, and other governmental and private groups.

(ii) *NCUA Central Liquidity Facility (CLF).* The CLF was created to improve general financial stability by providing funds to meet the liquidity needs of credit unions. It is a mixed-ownership Government corporation under the Government Corporation Control Act (31 U.S.C. 9101, *et seq.*). The CLF is managed by the President of the CLF, under the general supervision of the NCUA Board which serves as the CLF Board of Directors. The Chairman of the NCUA Board serves as the Chairman of the CLF Board of Directors. The Secretary of the NCUA Board serves as the Secretary of the CLF Board. The Director of the Division of Risk Management, Office of Examination and Insurance, serves as the President of the CLF.

(7) *Office of the Executive Director.* The Executive Director translates NCUA Board policy decisions into workable programs, delegates responsibility for these programs to appropriate staff members, and coordinates the activities of the senior executive staff, which includes: the General Counsel; the Regional Directors; and the Office Directors for Administration, Chief Financial Officer, Examination and Insurance, Human Resources, Information Systems, and Public and Congressional Affairs. Because of the nature of the attorney/client relationship between the Board and General Counsel, the General Counsel may be directed by the Board not to disclose discussions and/or assignments with anyone, including the Executive Director. The Executive Director is otherwise to be privy to all matters within senior executive staff's responsibility.

(8) *Office of General Counsel.* The General Counsel has overall responsibility for all legal matters affecting NCUA and for liaison with the Department of Justice. The General Counsel represents NCUA in all litigation and administrative hearings when such direct representation is permitted by law and, in other instances, assists the attorneys responsible for the conduct of such litigation. The General Counsel also provides NCUA with legal advice and opinions on all matters of law, and the public with interpretations of the Federal Credit Union Act, the NCUA Rules and Regulations, and other NCUA Board directives. The General Counsel has responsibility for the drafting, reviewing, and publication of all items which appear in the **Federal Register**, including rules, regulations, and notices required by law. The office has responsibility for processing Freedom of Information requests and appeals.

(9) *The Office of Human Resources.* The Office of Human Resources provides a comprehensive program for the management of NCUA's human resources. This is done in support of NCUA's goal to recruit, develop, and retain a quality and representative workforce. The Director is responsible for managing NCUA's compensation program, for facilitating good organization design, for staffing positions through recruitment and merit promotion programs, and for maintaining an automated personnel records system. The Director is also responsible for the Board's performance management, incentive awards, employee assistance, and benefit programs. These programs are geared to foster healthy employee/

management relations and to provide employees with good working conditions.

(10) *Office of Technology and Information Services.* The Director of the Office of Technology and Information Services has responsibility for the management and administration of NCUA's information resources. This includes the development, maintenance, operation, and support of information systems which directly support the Agency's mission, maintaining and operating the Agency's information processing infrastructure, responding to requests for releaseable Agency information, and insuring all related material security and integrity risks are recognized and controlled as much as possible.

(11) *Office of the Inspector General.* The Inspector General reports directly to the Board and provides semiannual reports regarding audit and investigation activities to the Board and the Congress. The Inspector General is responsible for: (a) conducting independent audits and investigations of all NCUA programs and functions to promote efficiency; (b) reviewing policies and procedures to evaluate controls to prevent fraud, waste, and abuse; and (c) reviewing existing and proposed legislation and regulations to evaluate their impact on the economic and efficient administration of the Agency.

(12) *Office of Public and Congressional Affairs.* The Director of the Office of Public and Congressional Affairs is responsible for maintaining NCUA's relationship with the public and the media; for liaison with the U.S. Congress, and with other Executive Branch agencies concerning legislative matters; and for the analysis and development of legislative proposals and public affairs programs.

(13) *Office of Community Development Credit Unions.* This Office is responsible for coordinating NCUA policy as it relates to community development credit unions, including those credit unions designated as "low-income." The Office administers the Community Development Revolving Loan Program for Credit Unions (Program). This Program was funded from a congressional appropriation and serves as a loan and technical assistance vehicle for low-income credit unions. The Office Director serves as Program Chairman and authorizes loans and technical assistance to participating credit unions. The Program is governed by part 705 of subchapter A of this chapter.

(14) *Office of Investment Services.* The Office of Investment Services is responsible for providing investment expertise and advice to the Board and agency staff. A working relationship is maintained with the financial marketplace to develop resources available to the NCUA and keep abreast of product initiatives. The NCUA Investment Hotline housed in this Office is a toll-free number that is available to examiners, credit unions, and financial product vendors to ask investment related questions. The Hotline provides NCUA an opportunity to be aware of current investment issues as they arise in credit unions and has permitted NCUA to become proactive, rather than reactive, to such issues. In addition, investment officers advise agency management on the purchase of authorized investments for the NCUSIF and the CLF.

(15) *Office of Training and Development.* This Office provides a comprehensive program for the training and development of NCUA's staff. The Office is responsible for developing policy, consistent with the Government Employees Training Act, related to its training program; for providing training opportunities equitably so that all employees have the skills necessary to help meet the agency's mission; for evaluating the agency's training and development efforts; and for ensuring that the agency's training monies are spent in a cost efficient manner and in accordance with the law.

(16) *Office of Corporate Credit Unions.* The Director, Office of Corporate Credit Unions, manages NCUA's corporate credit union program in accordance with established policies and the corporate regulation. The Director's duties include directing chartering, examination and supervision programs to promote and assure safety and soundness; managing NCUA's corporate resources to meet program objectives in the most economical and practical manner, and maintaining good public relations with public, private and governmental organizations, corporate credit union officials, credit union organizations, and other groups which have an interest in corporate credit union matters.

(c) *Regional Offices.*

(1) NCUA's programs are conducted through six Regional Offices:

(2) A Regional Director is in charge of each Regional Office. The Regional Director manages NCUA's programs in the Region assigned in accordance with established policies. This person's duties include: directing chartering, insurance, examination, and supervision programs to promote and assure safety and soundness; managing re-

gional resources to meet program objectives in the most economical and practical manner; and maintaining good public relations with public, private, and governmental organizations, Federal credit union officials, credit union organizations, and other groups which have an interest in credit union matters in the assigned Region. The Director maintains liaison and cooperation with other regional offices of Federal departments and agencies, state agencies, city and county officials, and other governmental units that affect credit unions. The Regional Director is aided by an Associate Regional Director for Operations and Associate Regional Director for Programs. Staff working in the Regional Office report to the Associate Regional Director for Operations. Each region is divided into examiner districts, each assigned to a Supervisory Credit Union Examiner; groups of examiners are directed by a Supervisory Credit Union Examiner, each of whom in turn reports directly to the Associate Regional Director for Programs.

Region No.	Area Within Region	Office Address
I	Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont	9 Washington Square Washington Avenue Extension Albany, NY 12205
II	Delaware, District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia, West Virginia	1775 Duke Street Suite 4206 Alexandria, VA 22314–3437
III	Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Puerto Rico, South Carolina, Tennessee, Virgin Islands	7000 Central Parkway Suite 1600 Atlanta, GA 30328
IV	Illinois, Indiana, Michigan, Missouri, Ohio, Wisconsin	4225 Naperville Road Suite 125 Lisle, IL 60532
V	Arizona, Colorado, Iowa, Kansas, Minnesota, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Utah, Wyoming	4807 Spicewood Springs Road Suite 5200 Austin, TX 78759
VI	Alaska, American Samoa, California, Guam, Hawaii, Idaho, Montana, Nevada, Oregon, Washington	2300 Clayton Road Suite 1350 Concord, CA 94520

§ 790.3 Requests for Action.

Except as otherwise provided by NCUA regulation, all applications, requests, and submittals for action by the NCUA shall be in writing and addressed to the appropriate office described in § 790.2. This will usually be one of the Regional Offices. In instances where the appropriate office cannot be determined, requests should be sent to the Office of Public and Congressional Affairs.

Part 791

Rules of NCUA Board Procedure; Promulgation of NCUA Rules and Regulations; Public Observation of NCUA Board Meetings

Subpart A—Rules of NCUA Board Procedure

§ 791.1 Scope.

The rules contained in this Subpart are the rules of procedure governing how the Board conducts its business. These rules concern the Board's exercise of its authority to act on behalf of NCUA; the conduct, scheduling and subject matter of Board meetings; and the recording of Board action.

§ 791.2 Number of Votes Required for Board Action.

The agreement of at least two of the three Board members is required for any action by the Board.

§ 791.3 Voting by Proxy.

Proxy voting shall not be allowed for any action by the Board.

§ 791.4 Methods of Acting.

(a) *Board Meeting.*

(1) *Applicability of the Sunshine Act.* The Government in the Sunshine Act (5 U.S.C. 552b, "Sunshine Act") requires that joint deliberations of the Board be held in accordance with its open meetings provisions (5 U.S.C. 552b(b)–(f)). (Subpart C of this Part contains NCUA's regulations implementing the Sunshine Act.)

(2) *Presiding Officer.* The Chairman is the presiding officer, and in the Chairman's absence, the designated Vice Chairman shall preside. The presiding officer shall make procedural rulings with the right of the objector to request a board ruling.

(b) *Notation Voting.* Notation voting is the circulation of written memoranda and voting sheets to the office of each Board member and the tabulation of responses.

(1) *Matters that may be Decided by Notation Voting.* Notation voting may be used only for routine matters.

(2) *Notation Vote Sheets.* Notation vote sheets will be used to record the vote tally on a notation vote. The Secretary of the Board has administrative responsibility over notation voting, including the authority to establish deadlines for voting, receive notation vote sheets, count votes, and determine whether further action is required.

(3) *Veto of Notation Voting.* In view of public policy for openness reflected in the Sunshine Act, each Board member is authorized to veto the use of notation voting for the consideration of any particular matter, and thus require that the matter be placed on the agenda of a Board meeting.

(4) *Disclosure of Result.* A record is to be maintained of Board transactions by use of the notation voting procedure. Public disclosure of this record is determined by the provisions of the Freedom of Information Act (5 U.S.C. § 552).

§ 791.5 Scheduling of Board Meetings.

(a) *Meeting Calls.*

(1) *Regular Meetings.* The Board will hold regular meetings each month unless there is no business or a quorum is not available. The Secretary of the Board will coordinate the dates for meetings.

(2) *Special Meetings.* The Chairman shall call special meetings either on the chairman's own initiative or at the request of any Board member.

(b) *Notice of Meetings.*

(1) *Notifying the Public.* The Sunshine Act and Subpart C set forth the procedures for notifying the public of Board meetings.

(2) *Notifying Board Members.*

(i) *Special Meetings.* Except in cases of emergency as determined by a majority of the Board, each Board member is entitled to receive notice of any special meeting at least twenty-four hours in advance of such meeting. The notice shall set forth the place, day, hour, and nature of business to be transacted at the meet-

ing. In cases of emergency, a record of the vote, including a statement explaining the decision that an emergency exists, will be maintained.

(ii) *Regular Meetings.* Each Board member entitled to receive notice of the agenda and/or notice of any changes in the subject matter of such meetings concurrent with the public release of such notices under the Sunshine Act. Each Board member shall be entitled to at least twenty-four hours advance notice of the consideration of a particular subject matter, except in cases of emergency as determined by a majority of the Board. In cases of emergency, a record of the vote, including a statement explaining the decision that an emergency exists, will be maintained.

§ 791.6 Subject Matter of a Meeting.

(a) *Agenda.* The Chairman is responsible for the final order of each meeting agenda. Items shall be placed on the agenda by determination of the chairman, or within 60 days of receipt of a written request from two Board members that includes an NCUA B–1 form and a Board Action Memorandum.

(b) *Submission of Recommended Agenda Items.* Recommended agenda items may be submitted to the Secretary of the Board by Board members, the Executive Staff (which includes all Office Directors and President of the Central Liquidity Facility), and Regional Directors.

Subpart B—Promulgation of NCUA Rules and Regulations

§ 791.7 Scope.

The rules contained in this Subpart B pertain to the promulgation of NCUA Rules and Regulations.

§ 791.8 Promulgation of NCUA Rules and Regulations.

(a) NCUA's procedures for developing regulations are governed by the Administrative Procedure Act (5 U.S.C. 551 et seq.), the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), the Paperwork Reduction Act (44 U.S.C. 3501 et seq.), and NCUA's policies for the promulgation of rules and regulations as set forth in its Interpretive Ruling and Policy Statement 87–2.

(b) *Proposed Rulemaking.* Notices of proposed rulemaking are published in the Federal Register except as specified in paragraph (d) or as otherwise provided by law. A notice of proposed rulemaking may also be identified as a "request for comments" or as a "proposed rule." The notice will include:

(1) a statement of the nature of the rulemaking proceedings;

(2) reference to the authority under which the rule is proposed;

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved; and

(4) a statement of the effect of the proposed rule on state-chartered federally-insured credit unions.

(c) *Public Participation.* After publication of notice of proposed rulemaking, interested persons will be afforded the opportunity to participate in the making of the rule through the submission of written data, views, or arguments, delivered within the time prescribed in the notice of proposed rulemaking, to the Secretary, NCUA Board, 1775 Duke Street, Alexandria, VA 22314–3428. Interested persons may also petition the Board for the issuance, amendment, or repeal of any rule by mailing such petition to the Secretary of the Board at the address given in this section.

(d) *Exceptions to Notice.* The following are not subject to the notice requirement contained in paragraph (b) of this section:

(1) matters relating to agency management or personnel or to public property, loans, grants, benefits, or contracts;

(2) when persons subject to the proposed rule are named and either personally served or otherwise have actual notice thereof in accordance with law;

(3) interpretive rules, general statements of policy, or rules of agency organization, procedure or practice, unless notice or hearing is required by statute; and

(4) if the Board, for good cause, finds (and incorporates the finding and a brief statement therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest, unless notice or hearing is required by statute.

(e) *Effective Dates.* No substantive rule issued by NCUA shall be effective less than 30 days after its publication in the Federal Register, except that this requirement may not apply to:

(1) rules which grant or recognize an exemption or relieve a restriction;

(2) interpretive rules and statements of policy; or

(3) any substantive rule which the Board makes effective at an earlier date upon good cause found and published with such rule.

Subpart C—Public Observation of NCUA Board Meetings Under the Sunshine Act

§ 791.9 Scope.

This subpart contains regulations implementing subsections (b) through (f) of the "Government in the Sunshine Act" [5 U.S.C. § 552b]. The primary purpose of these regulations is to provide the public with the fullest access authorized by law to the deliberations and decisions of the Board, while protecting the rights of individuals and preserving the ability of the agency to carry out its responsibilities.

§ 791.10 Definitions.

For the purpose of this subpart:

(a) "agency" means the National Credit Union Administration;

(b) "Board" means the National Credit Union Administration Board, whose members were appointed by the President with the advice and consent of the Senate;

(c) "subdivision of the Board" means a group composed of two Board members authorized by the Board to act on behalf of the agency;

(d) "meeting" means any deliberations by two or more members of the Board or any subdivision of the Board that determine or result in the joint conduct or disposition of official agency business with the exception of:

(1) deliberations to determine whether a meeting or a portion thereof will be open or closed to public observation and whether information regarding closed meetings will be withheld from public disclosure;

(2) deliberations to determine whether or when to schedule a meeting; and

(3) infrequent dispositions of official agency business by sequential circulation of written recommendations to individual Board members ("notation voting procedure"), provided the votes of each Board member and the action taken are recorded for each matter and are publicly available, unless exempted from disclosure pursuant to 5 U.S.C. § 552 (the Freedom of Information Act);

(e) "public observation" means that a member or group of the public may listen to and observe any open meeting and may record in an unobtrusive manner any portion of that meeting by use of a camera or any other electronic device, but shall not participate in any meeting unless authorized by the Board;

(f) "public announcement" or "publicly announce" means reasonable efforts under the particular circumstances to fully inform the public, especially those individuals who have expressed interest in the subject matters to be discussed or the decisions of the agency;

(g) "Sunshine Act" means the open meeting provisions of the "Government in the Sunshine Act" (5 U.S.C. § 552b).

§ 791.11 Open Meetings.

Except as provided in Section 791.12(a), any portion of any meeting of the Board shall be open to public observation. The Board, and any subdivision of the Board, shall jointly conduct official agency business only in accordance with this subpart.

§ 791.12 Exemptions.

(a) Under the procedures specified in Section 791.14, the Board may close a meeting or any portion of a meeting from public observation or may withhold information pertaining to such meetings provided the Board has properly determined that the public interest does not require otherwise and that the meeting (or any portion thereof) or the disclosure of meeting information is likely to:

(1) disclose matters that are (i) specifically authorized under criteria established by an Executive Order to be kept secret in the interests of national defense or foreign policy, and (ii) in fact properly classified pursuant to such Executive Order;

(2) relate solely to internal personnel rules and practices;

(3) disclose matters specifically exempted from disclosure by statute (other than Section 552 of Title 5 of the United States Code, the Freedom of Information Act), provided that such statute (i) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (ii) establishes

particular criteria for withholding or refers to particular types of matters to be withheld;

(4) disclose trade secrets and commercial or financial information obtained from a person and privileged or confidential;

(5) involve accusing any person of a crime, or formally censuring any person;

(6) disclose information of a personal nature where disclosure would constitute a clearly unwarranted invasion of personal privacy;

(7) disclose investigatory records compiled for enforcement purposes, or information which if written would be contained in such records, but only to the extent that the production of such records or information would (i) interfere with enforcement proceedings, (ii) deprive a person of a right to a fair trial or an impartial adjudication, (iii) constitute an unwarranted invasion of personal privacy, (iv) disclose the identity of a confidential source and, in the case of a record compiled by a criminal law enforcement authority in the course of a criminal investigation, or by a Federal agency conducting a lawful national security intelligence investigation, confidential information furnished only by the confidential source, (v) disclose investigation techniques and procedures, or (vi) endanger the life or physical safety of law enforcement personnel;

(8) disclose information contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of Federal agencies responsible for the regulation or supervision of financial institutions;

(9) disclose information the premature disclosure of which would be likely to (A)(i) lead to significant speculation in currencies, securities, or commodities, or (ii) significantly endanger the stability of any financial institution, or (B) be likely to significantly frustrate implementation of a proposed action, except that this subparagraph shall not apply in any instance where the Board has already disclosed to the public the content or nature of its proposed action, or where the Board is required by law to make such disclosure on its own initiative prior to taking final action on such proposal; or

(10) specifically concern the issuance of a subpoena, participation in a civil action or proceeding, an action in a foreign court or international tribunal, or an arbitration, or the initiation, conduct or disposition of a particular case of formal agency adjudication pursuant to the procedures in Section 554 of Title 5 of the United States Code or otherwise involving a determination on the record after opportunity for a hearing.

(b) Prior to closing a meeting whose discussions are likely to fall within the exemptions stated in paragraph (a) of this Section, the Board will balance the public interest in observing the deliberations of an exemptible matter and the agency need for confidentiality of the exemptible matter. In weighing these interests, the Board is assisted by the General Counsel as provided in Section 791.16, by expressions of the public interest set forth in requests for open meetings as provided by Section 791.15(b), and by the brief staff analysis of public interest which will accompany each staff recommendation that an agenda item be considered in a closed meeting.

§ 791.13 Public Announcement of Meetings.

(a) Except as otherwise provided in this Section, the Board shall, for each meeting, make a public announcement, at least one week in advance of the meeting, of the time, place and subject matter of the meeting, whether it will be open or closed to public observation, and the name and telephone number of the Secretary of the Board or the person designated by the Board to respond to requests for information about the meeting.

(b) Advance notice is required unless a majority of the members of the Board determine by a recorded vote that agency business requires that a meeting be called at an earlier date, in which case, the information to be announced in paragraph (a) of this Section shall be publicly announced at the earliest practicable time.

(c) A change, including a postponement or a cancellation, in the time or place of a meeting after a published announcement may be made only if announced at the earliest practicable time.

(d) A change in or deletion of the subject matter of a meeting or any portion of a meeting or a redetermination to open or close a meeting or any portion of a meeting after a published announcement may be made only if (1) a majority of the Board determines by recorded vote that agency business so requires and that no earlier announcement of the change was possible and (2) public announcement of the change and of the vote of each member on such change shall be made at the earliest practicable time.

(e) Each meeting announcement or amendment thereof shall be posted on the Public Notice Bul-

letin Board in the reception area of the agency headquarters and may be made available by other means deemed desirable by the Board. Immediately following each public announcement required by this Section, the stated information shall be submitted to the Federal Register for publication.

(f) No announcement shall contain information which is determined to be exempt from disclosure under Section 791.12(a).

(g) The agency shall maintain a mailing list of names and addresses of all persons who wish to receive copies of agency announcements of meetings open to public observation and amendments to such announcements. Requests to be placed on the mailing list should be made by telephoning or by writing to the Secretary of the Board.

§ 791.14 Regular Procedure for Closing Meeting Discussions or Limiting the Disclosure of Information.

(a) A decision to close any portion of a meeting and to withhold information about any portion of a meeting closed pursuant to Section 791.12(a) will be taken only when a majority of the entire Board votes to take such action. In deciding whether to close a meeting or any portion of a meeting or to withhold information, the Board shall independently consider whether the public interest requires an open meeting. A separate vote of the Board will be taken and recorded for each portion of a meeting to be closed to public observation pursuant to Section 791.12(a) or to withhold information from the public pursuant to Section 791.12(a). A single vote may be taken and recorded with respect to a series of meetings, or any portions of meetings which are proposed to be closed to the public, or with respect to any information concerning the series of meetings, so long as each meeting in the series involves the same particular matters and is scheduled to be held no more than thirty days after the initial meeting in such series. No proxies shall be allowed.

(b) Any person whose interests may be directly affected by any portion of a meeting for any of the reasons stated in subparagraphs (5), (6) or (7) of Section 791.12(a) may request that the Board close such portion of the meeting. After receiving notice of a person's desire for any specified portion of a meeting to be closed, the Board, upon a request by one member, will decide by recorded vote whether to close the relevant portion or portions of the meeting. This procedure applies to requests received either prior or subsequent to the announcement of a decision to hold an open meeting.

(c) Within one day after any vote is taken pursuant to paragraphs (a) or (b) of this Section, the Board shall make publicly available a written copy of the vote taken indicating the vote of each Board member. Except to the extent that such information is withheld and exempt from disclosure, for each meeting or any portion of a meeting closed to the public, the Board shall make publicly available within one day after the required vote, a written explanation of its action, together with a list of all persons expected to attend the closed meeting and their affiliation. The list of persons to attend need not include the names of individual staff, but shall state the offices of the agency expected to participate in the meeting discussions.

§ 791.15 Requests for Open Meeting.

(a) Following any announcement that the Board intends to close a meeting or any portion of any meeting, any person may make a written request to the Secretary of the Board that the meeting or a portion of the meeting be open. The request shall be circulated to the members of the Board, and the Board, upon the request of one member, shall reconsider its action under Section 791.14 before the meeting or before discussion of the matter at the meeting. If the Board decides to open a portion of a meeting proposed to be closed, the Board shall publicly announce its decision in accordance with Section 791.13(e). If no request is received from a Board member to reconsider the decision to close a meeting or portion thereof prior to the meeting discussion, the Chairman of the Board shall certify that the Board did not receive a request to reconsider its decision to close the discussion of the matter.

(b) The request to open a portion of a meeting shall be submitted to the Secretary of the Board in advance of the meeting in question. The request shall set forth the requestor's interest in the matter to be discussed and the reasons why the requestor believes that the public interest requires that the meeting or portions thereof be open to public observation.

(c) The submission of a request to open a portion of a meeting shall not act to stay the effectiveness of Board action or to postpone or delay the meeting unless the Board decides otherwise.

(d) The Secretary of the Board shall advise the requestor of the Board's consideration of the request to open a portion of the meeting as soon as practicable.

§ 791.16 General Counsel Certification.

For each meeting or any portion of a meeting closed to public observation under Section 791.14, the General Counsel shall publicly certify, whether in his or her opinion, the meeting or portion thereof may be closed to public observation and shall state each relevant exemption provision of law. A copy of the certification, together with a statement from the presiding officer of the meeting setting forth the time and place of the meeting and the persons present, shall be retained as a part of the permanent meeting records. As part of the certification, the General Counsel shall recommend to the Board whether the public interest requires that the meeting or portions thereof proposed to be closed to public observation be held in the open.

§ 791.17 Maintenance of Meeting Records.

(a) Except in those circumstances which are beyond the control of the agency, the Board shall maintain a complete transcript or electronic recording adequate to record fully the proceedings of each meeting, or any portion thereof, closed to public observation. However, for meetings closed under subparagraphs (8), (9)(A) or (10) of Section 791.12(a), the Board shall maintain either a transcript, a recording or a set of minutes. The Board shall maintain a complete electronic recording for each open meeting or any portion thereof. All records shall clearly identify each speaker.

(b) A set of minutes shall fully and clearly describe all matters discussed and shall provide a full and accurate summary of any actions taken, and the reasons for taking such action. Minutes shall also include a description of each of the views expressed by each person in attendance on any item and the record of any roll call vote, reflecting the vote of each member. All documents considered in connection with any action shall be identified in the minutes.

(c) The agency shall maintain a complete verbatim copy of the transcript, a complete copy of the minutes or a complete electronic recording of each meeting, or any portion of a meeting, closed to public observation, for at least two years after such meeting or for one year after the conclusion of any agency proceeding with respect to which the meeting or any portion was held, whichever occurs later. The agency shall maintain a complete electronic recording of each open meeting for at least three months after the meeting date. A complete set of minutes shall be maintained on a permanent basis for all meetings.

§ 791.18 Public Availability of Meeting Records and Other Documents.

(a) The agency shall make promptly available to the public, in the Public Reference Room, the transcript, electronic recording, or minutes of any meeting, deleting any agenda item or any item of the testimony of a witness received at a closed meeting which the Board determined, pursuant to paragraph (c) of this Section, was exempt from disclosure under Section 791.12(a). The exemption or exemptions relied upon for any deleted information shall be reflected on any record or recording.

(b) Copies of any transcript, minutes or transcription of a recording, disclosing the identity of each speaker, shall be furnished to any person requesting such information in the form specified in paragraph (a) of this Section. Copies shall be furnished at the actual cost of duplication or transcription unless waived by the Secretary of the Board.

(c) Following each meeting or any portion of a meeting closed pursuant to § 791.12(a), the General Counsel or his designee, after consultation with the Secretary of the Board, shall determine which, if any, portions of the meeting transcript, electronic recording or minutes not otherwise available under 5 U.S.C. 552a (the Privacy Act) contain information which should be withheld pursuant to § 791.12(a). If, at a later time, the Board determines that there is no further justification for withholding any meeting record or other item of information from the public which has previously been withheld, then such information shall be made available to the public.

(d) Except for information determined by the Board to be exempt from disclosure pursuant to paragraph (c) of this Section, meeting records shall be promptly available to the public in the Public Reference Room. Meeting records include but are not limited to: the transcript, electronic recording or minutes of each meeting, as required by Section 791.17(a); the notice requirements of Section

791.13 and 791.14(c); and the General Counsel Certification along with the presiding officer's statement, as required by Section 791.16.

(e) These provisions do not affect the procedures set forth in Part 790, Subpart A, governing the inspection and copying of agency records, except that the exemptions set forth in Section 791.12(a) of this subpart and in 5 U.S.C. § 552b(c) shall govern in the case of a request made pursuant to Part 790, Subpart A, to copy or inspect the meeting records described in this Section. Any documents considered or mentioned at Board meetings may be obtained subject to the procedures set forth in Part 790, Subpart A.

Part 792

Requests for Information Under the Freedom of Information Act and Privacy Act, and by Subpoena; Security Procedures for Classified Information

Subpart A—The Freedom of Information Act

§ 792.1 Scope.

This Subpart sets forth the procedures for processing requests for information under the Freedom of Information Act ("FOIA") (5 U.S.C. § 552).

§ 792.2 Information made available to the public and requests for such information.

(a) Except to the extent that the matters set forth herein relate to or contain information which is exempted from public disclosure under the FOIA as amended (5 U.S.C. § 552) or are promptly published and copies are for sale, NCUA shall make available for public inspection and copying, upon request made in accordance with the provisions of § 792.2(g): (1) the final opinions, including concurring and dissenting opinions, and orders, made in the adjudication of cases; (2) those statements of policy and interpretations which have been adopted by NCUA and are not published in the *FEDERAL REGISTER*; and (3) administrative staff manuals and instructions to staff affecting a member of the public.

(b) To the extent required to prevent a clearly unwarranted invasion of personal privacy, NCUA may delete identifying details when an opinion, statement of policy, interpretation, or staff manual or instruction is made available or published. In each case, the justification for the deletion shall be fully explained in writing.

(c) NCUA also maintains current indices providing identifying information for the public for any matter referred to in paragraph (a) of this section issued, adopted, or promulgated after July 4, 1967. Manuals relating to general and technical information and booklets published by NCUA are listed on the "NCUA Publications List," which indicates those items available from the Agency. The Directory of Credit Unions, published by NCUA, is also available. A list of statements of policy, NCUA Instructions, Bulletins, Letters to Credit Unions and certain internal manuals are maintained on a "Directives Control Index." NCUA has determined that publication of the indices is unnecessary and impractical, but copies of indices will be provided on request at their duplication cost and are available for public inspection and copying. The listing of any material in any index is for the convenience of possible users of the materials and does not constitute a determination that all of the items listed will be disclosed or are subject to disclosure.

(d) The materials referred to in paragraph (a) of this section may be relied on, used, or cited as precedent by NCUA against a party, provided: (1) the materials have been indexed and either made available or published; or (2) the party has actual and timely notice of the materials' contents.

(e) Except with respect to records made available under this section or published in the *FEDERAL REGISTER*, or to the extent that records relate to or contain information which is exempt from public disclosure under the FOIA, NCUA, upon a request which reasonably describes records and is made in accordance with § 792.2(g), will make such records available to any person who agrees to pay the direct costs specified in § 792.5. A "reasonable description" is one which is sufficient to enable a professional employee of NCUA, who is familiar with the subject area of the request, to locate the record with a reasonable amount of effort.

(f) *Information Centers.* The Central Office, Regional Offices and the Asset Management and Assistance Center are the designated Information Centers for the NCUA. The Freedom of Information Officer of the Office of General Counsel is responsible for the operation of the Information Center maintained at the Central Office. The Regional Directors are responsible for the operation of the Information Centers in their Regional Offices. The President of the Asset Management and Assistance Center is responsible for the operation of the Information Center maintained there.

(g) *Methods of request.*

(1) *Indices.* Requests for indices should be made to NCUA, Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314–3428. The indices indicate how to obtain the documents listed therein.

(2) *All other records.* Requests for all other records made under Section 792.3(e) should be addressed to the appropriate Regional Director. When the location of requested records is not known, or it is known that such records are located in the Central Office, the request should be addressed to the Freedom of Information Officer of the Office of the General Counsel at the address noted in paragraph (g)(1) of this section.

(3) *Improper address.* Failure to properly address a request may defer the effective date of receipt by NCUA for commencement of the time limitation stated in Section 792.6(a)(i), to take account of the time reasonably required to forward the request to the appropriate office or employee.

§ 792.3 Unpublished, confidential and privileged information.

(a) All records of NCUA or any officer, employee, or agent thereof, are confidential, privileged and not subject to disclosure, except as otherwise provided in this Part, if such records are:

(1) Records specifically authorized under criteria established by an Executive Order to be kept secret in the interest of national defense or foreign policy and are in fact properly classified pursuant to an Executive Order.

(2) Records related solely to NCUA internal personnel rules and practices. This exemption applies to internal rules or instructions which must be kept confidential in order to assure effective performance of the functions and activities for which NCUA is responsible and which do not materially affect members of the public. This exemption also applies to manuals and instructions to the extent that release of the information contained therein would permit circumvention of laws or regulations.

(3) Specifically exempted from disclosure by statute, where the statute either makes nondisclosure mandatory or establishes particular criteria for withholding information.

(4) Records which contain trade secrets and commercial or financial information which relate to the business, personal or financial affairs of any person or organization, are furnished to NCUA, and are confidential or privileged. This exemption includes, but is not limited to, various types of confidential sales and cost statistics, trade secrets, and names of key customers and personnel. Assurances of confidentiality given by staff are not binding on NCUA.

(5) Inter-agency or intra-agency memoranda or letters which would not be available by law to a private party in litigation with NCUA. This exemption preserves the existing freedom of NCUA officials and employees to engage in full and frank written or taped communications with each other and with officials and employees of other agencies. It includes, but is not limited to, inter-agency and intra-agency reports, memoranda, letters, correspondence, work papers, and minutes of meetings, as well as staff papers prepared for use within NCUA or in concert with other governmental agencies.

(6) Personnel, medical, and similar files (including financial files), the disclosure of which without written permission would constitute a clearly unwarranted invasion of personal privacy. Files exempt from disclosure include, but are not limited to: (i) the personnel records of the NCUA; (ii) the personnel records voluntarily submitted by private parties in response to NCUA's requests for proposals; and (iii) files containing reports, records or other material pertaining to individual cases in which disciplinary or other administrative action has been or may be taken.

(7) Records or information compiled for law enforcement purposes, but only to the extent that the production of such law enforcement records or information: (i) could reasonably be expected to interfere with enforcement proceedings; (ii) would deprive a person of a right to a fair trial or an impartial adjudication; (iii) could reasonably be expected to constitute an unwarranted invasion of personal privacy; (iv) could reasonably be expected to disclose the identity of a confidential source, including a state, local, or foreign agency or authority or any private institution which furnished information on a confidential basis, and, in the case of a record or information compiled by a criminal law enforcement authority in the course of a criminal investigation on or by an agency conducting a lawful national security intelligence investigation, information furnished by the confidential source; (v) would disclose techniques and procedures for law enforcement investigation or prosecutions, or would disclose guidelines for law enforcement investigations or prosecutions if such disclosure could reasonably be expected to risk circumvention of the law; or (vi) could reasonably be expected to endanger the life or physical safety of any individual. This includes, but is not limited to, information relat-

ing to enforcement proceedings upon which NCUA has acted or will act in the future.

(8) Contained in or related to examination, operating or condition reports prepared by, or on behalf of, or for the use of NCUA or any agency responsible for the regulation or supervision of financial institutions. This includes all information, whether in formal or informal report form, the disclosure of which would harm the financial security of credit unions or would interfere with the relationship between NCUA and credit unions.

§ 792.4 Release of exempt records.

(a) *Prohibition against disclosure.* Except as provided in § 792.4(b), no officer, employee, or agent of NCUA or of any federally-insured credit union shall disclose or permit the disclosure of any exempt records of the Agency to any person other than those NCUA or credit union officers, employees, or agents properly entitled to such information for the performance of their official duties.

(b) *Disclosure authorized.* Exempt NCUA records may be disclosed only in accordance with the following conditions and requirements:

(1) *Exempt records—Disclosure to credit unions, financial institutions and state and Federal agencies.* The NCUA Board or any person designated by it in writing, in its sole discretion, may make available to certain governmental agencies and insured financial institutions copies of reports of examination and other documents, papers or information for their use, when necessary, in the performance of their official duties or functions. All reports, documents and papers made available pursuant to this paragraph shall remain the property of NCUA. No person, agency or employee shall disclose the reports or exempt records without NCUA's express written authorization.

(2) *Exempt records—Disclosure to investigatory agencies.* The NCUA Board, or any person designated by it in writing, in its discretion and in appropriate circumstances, may disclose to proper Federal or state authorities copies of exempt records pertaining to irregularities discovered in credit unions which may constitute either unsafe or unsound practices or violations of Federal or state civil or criminal law.

(3) *Exempt records—Disclosure to third parties.* The NCUA Board, or any person designated by it in writing, may disclose copies of exempt records to any third party where requested to do so in writing. The request shall: (i) specify the record or records to which access is requested; and (ii) give the reasons for the request. Any NCUA employee authorized to disclose exempt NCUA records to third parties may disclose the records only upon determining that good cause exists for the disclosure. The designated NCUA official shall impose such terms and conditions as are deemed necessary to protect the confidential nature of the record, the financial integrity of any credit union or other organization or person to which the records relate, and the legitimate privacy interests of any individual named in such records.

§ 792.5 Fees for document search, review, and duplication; waiver and reduction of fees.

(a) *Definitions.*

(1) "Direct costs" means those expenditures which NCUA actually incurs in searching for, duplicating and reviewing documents to respond to a FOIA request.

(2) "Search" means all time spent looking for material that is responsive to a request, including page-by-page or line-by-line identification of material within documents. Searches may be done manually or by computer using existing programming.

(3) "Duplication" means the process of making a copy of a document needed to respond to a FOIA request.

(4) "Review" means: (i) the process of examining documents located in response to a request that is for a commercial use (see subsection 792.5(a)(5)) to determine whether any portion of a document located is permitted to be withheld; and (ii) the process of preparing such documents for disclosure.

(5) "Commercial use request" means a request from or on behalf of one who seeks information for a use or purpose that furthers the commercial, trade, or profit interests of the requester or the person on whose behalf the request is made.

(6) "Educational institution" means a preschool, an elementary or secondary school, an institution of undergraduate higher education, an institution of graduate higher education, an institution of professional education, and an

institution of vocational education operating a program or programs of scholarly research.

(7) "Noncommercial scientific institution" means an institution: (i) that is not operated on a "commercial" basis as that term is used in subsection 792.5(a)(5); and (ii) that is operated solely for the purpose of conducting scientific research, the results of which are not intended to promote any particular product or industry.

(8) "Representative of the news media" means any person actively gathering news for an entity that is organized and operated to publish or broadcast news to the public. Included within the meaning of "public" is the credit union community. The term "news" means information that is about current events or that would be of current interest to the public.

(b) *Fees to be charged.*

NCUA will charge fees that recoup the full allowable direct costs it incurs. NCUA may contract with the private sector to locate, reproduce and/or disseminate records. Fees are subject to change as costs increase. In no case will NCUA contract out responsibilities which the FOIA requires it alone to discharge, such as determining the applicability of an exemption, or determining whether to waive or reduce fees.

(1) Manual searches and review—NCUA will charge fees at the following rates for manual searches for and review of records:

(i) If search/review is done by clerical staff, the hourly rate for CU–5, step 1, plus 16 percent of that rate to cover benefits;

(ii) If search/review is done by professional staff, the hourly rate for CU–13, step 1, plus 16 percent of that rate to cover benefits.

(2) Computer searches—NCUA will charge fees at the hourly rate for CU–13, step 1, plus 16 percent of that rate to cover benefits, plus the hourly cost of operating the computer for computer searches for records.

(3) Duplication of records

(i) The per-page fee for paper copy reproduction of a document is $.25;

(ii) The fee for documents generated by computer is the hourly fee for the computer operator, plus the cost of materials (computer paper, tapes, labels, etc.);

(iii) If any other method of duplication is used, NCUA will charge the actual direct cost of duplicating the documents.

(4) Fees to exceed $25—If NCUA estimates that duplication and/or search fees are likely to exceed $25, it will notify the requester of the estimated amount of fees, unless the requester has indicated in advance willingness to pay fees as high as those anticipated. The requester will then have the opportunity to confer with NCUA personnel to reformulate the request to meet the person's needs at a lower cost.

(5) Other services—Complying with requests for special services is entirely at the discretion of NCUA. NCUA will recover the full costs of providing such services to the extent it elects to provide them.

(6) Restriction on assessing fees—NCUA will not charge fees to any requester, including commercial use requesters, if the cost of collecting a fee would be equal to or greater than the fee itself.

(7) Waiving or reducing fees—NCUA shall waive or reduce fees under this section whenever disclosure of information is in the public interest because it is likely to contribute significantly to public understanding of the operations or activities of the government, and is not primarily in the commercial interest of the requester.

(i) NCUA will make a determination of whether the public interest requirement above is met based on the following factors:

(A) The subject of the request: Whether the subject of the requested records concerns the operations or activities of the government;

(B) The informative value of the information to be disclosed: Whether the disclosure is likely to contribute to an understanding of government operations or activities;

(C) The contribution to an understanding of the subject by the general public likely to result from disclosure: Whether disclosure of the requested information will contribute to public understanding;

(D) The significance of the contribution to the public understanding: Whether the disclosure is likely to contribute significantly to public understanding of government operations or activities;

(ii) If the public interest requirement is met, NCUA will make a determination on the commercial interest requirement based upon the following factors:

(A) The existence and magnitude of a commercial interest: Whether the requester has a commercial interest that would be furthered by the requested disclosure; and if so

(B) The primary interest in disclosure: Whether the magnitude of the identified commercial interest of the requester is suffi-

ciently large in comparison with the public interest in disclosure, that disclosure is primarily in the commercial interest of the requester.

(iii) If the required public interest exists and the requester's commercial interest is not primary in comparison, NCUA will waive or reduce fees.

(c) *Categories of requesters.*

(1) Commercial use requesters—NCUA will assess commercial use requesters' fees which recover the full direct costs of searching for, reviewing for release, and duplicating the records sought. Commercial use requesters are not entitled to two hours of free search time or 100 free pages of reproduction of documents.

(2) Educational institution, noncommercial scientific institution, and requesters who are representatives of the news media—NCUA shall provide documents to requesters in this category for the cost of reproduction alone, excluding fees for the first 100 pages.

(3) All other requesters—NCUA shall charge requesters not included in either of the categories above fees which recover the full reasonable direct cost of searching for and reproducing records that are responsive to the request, except that the first 100 pages of reproduction and the first two hours of search time shall be furnished without a fee.

(d) *Interest on unpaid fees.*

NCUA may begin assessing interest charges on an unpaid bill starting on the 31st day following the day on which the bill was sent. Interest will be at the rate prescribed in Section 3717 of Title 31 U.S.C., and will accrue from the date of the billing.

(e) *Fees for unsuccessful search and review.*

NCUA may assess fees for time spent searching and reviewing, even if it fails to locate the records or if records located are determined to be exempt from disclosure.

(f) *Aggregating requests.*

A requester may not file multiple requests, each seeking portions of a document or documents, solely in order to avoid payment of fees. If this is done, NCUA may aggregate any such requests and charge accordingly.

(g) *Advance payment of fees.*

NCUA will require a requester to give an assurance of payment or an advance payment only when:

(1) NCUA estimates or determines that allowable charges that a requester may be required to pay are likely to exceed $250. NCUA will notify the requester of the likely cost and obtain satisfactory assurance of full payment where the requester has a history of prompt payment of FOIA fees, or require an advance payment of an amount up to the full estimated charges in the case of requester with no history of payment; or

(2) A requester has previously failed to pay a fee charged in a timely fashion. NCUA may require the requester to pay the full amount owed, plus any applicable interest as provided in subsection 792.5(d) or demonstrate that he has, in fact, paid the fee, and to make an advance payment of the full amount of the estimated fee before NCUA begins to process a new request or a pending request from that requester.

(3) When NCUA acts under subsections 792.5(g)(1) or (2), the administrative time limits prescribed in Section 792.6(a) will begin only after NCUA has received the fee payments described.

§ 792.6 Agency determination.

(a) Upon any request for records published in the *FEDERAL REGISTER*, or made available under § 792.2, NCUA will:

(1) Determine within 10 working days (excepting Saturdays, Sundays, and legal public holidays) after the receipt of any such request whether, or the extent to which, to comply with such request; and will upon such determination notify the person making the request that any adverse determination is not a final agency action, and that such person may appeal any adverse determination to the Office of General Counsel;

(2) make a determination with respect to any appeal within 20 days (excepting Saturdays, Sundays, and legal public holidays) after the receipt of such appeal. An appeal must be in writing and filed within 30 days from receipt of the initial determination (in cases of denials of an entire request), or from receipt of any records being made available pursuant to the initial determination (in cases of partial denials). If, on appeal, the denial of the request for records is in whole or in part upheld, the Office of General Counsel will notify the person making such request of the provisions for judicial review of that determination under the FOIA. In those cases where a request or appeal is not addressed to the proper official, the time

limitations stated above will be computed from the receipt of the request or appeal by the proper official.

(b) In unusual circumstances as specified herein, the time limits prescribed in either paragraph (a)(1) or (a)(2) of this Section may be extended by written notice to the person making such request, setting forth the reasons for such extension and the date on which a determination is expected to be dispatched. No such notice will specify a date that would result in an extension for more than 10 working days. "Unusual circumstances" means:

(1) the need to search for and collect the requested records from field facilities or other establishments that are separate from the office processing the request;

(2) the need to search for, collect, and appropriately examine a voluminous amount of separate and distinct records which are demanded in a single request; or

(3) the need for consultation, which will be conducted with all practicable speed, with another agency having substantial interest in the determination of the request or among two or more components of the Agency having substantial subject matter interest therein.

(c)(1) The appropriate Regional Director, the Freedom of Information Officer, or, in their absence, their designee, is responsible for making the initial determination on whether to grant or deny a request for information. This official may refer a request to a professional NCUA employee who is familiar with the subject area of the request. Other members of the NCUA's staff may aid the official by providing information, advice, recommending a decision, or implementing a decision, but no NCUA employee other than an authorized official may make the initial determination. Referral of a request by the official to an employee will not affect the time limitation imposed in paragraph (a)(1) of this Section unless the request involves an unusual circumstance as provided in paragraph (b) of this Section.

(2) The General Counsel is the official responsible for determining all appeals from initial determinations. In case of this person's absence, the appropriate officer acting in General Counsel's stead shall make the appellate determination, unless such officer was responsible for the initial determination, in which case the Vice-Chairman of the NCUA Board will make the appellate determination.

(3) All appeals should be addressed to the General Counsel in the Central Office and should be clearly identified as such on the envelope and in the letter of appeal by using the indicator "FOIA-APPEAL." Failure to address an appeal properly may delay commencement of the time limitation stated in paragraph (a)(2) of this Section, to take account of the time reasonably required to forward the appeal to the Office of General Counsel.

(d) Any person making a request to NCUA for records published in the *FEDERAL REGISTER*, or made available under § 792.2 shall be deemed to have exhausted administrative remedies with respect to such request if NCUA fails to comply with the applicable time limit provisions of this Section. On complaint filed in the appropriate U.S. District Court, if the Government can show exceptional circumstances exist and that NCUA is exercising due diligence in responding to the request, the court may retain jurisdiction and allow the Agency additional time to complete its review of the records. Upon any NCUA determination to comply with a request for records, the records will be made promptly available. Any notification of denial of any request for records under this section will set forth the names and titles or positions of each person responsible for the denial.

(e) In those cases where it is necessary to find and examine records before the legality or appropriateness of their disclosure can be determined, and where, after diligent effort, this has not been achieved within the required period, NCUA may advise the person making the request: that a determination to deny the request has been made because the records have not been found or examined; that this determination will be reconsidered when the search or examination is completed (and the time within which completion is expected); but that the person making the request may immediately file an administrative appeal.

§ 792.7 Confidential commercial information.

(a) Confidential commercial information provided to NCUA by a submitter shall be disclosed pursuant to a FOIA request in accordance with this Section.

(b) Definitions.

For purposes of this Section:

(1) "Confidential commercial information"—means commercial or financial information provided to NCUA by a submitter that arguably is protected from disclosure under Section 792.3(a)(4) because disclosure could reasonably

be expected to cause substantial competitive harm.

(2) "Submitter"—means any person or entity who provides business information, directly or indirectly, to NCUA.

(c) Designation of business information—Submitters of business information shall use good faith efforts to designate, by appropriate markings, either at the time of submission or at a reasonable time thereafter, those portions of their submissions deemed to be protected from disclosure under Section 792.3(a)(4). Such a designation shall expire ten years after the date of submission.

(d) Notice to submitters—NCUA shall provide a submitter with written notice of a FOIA request or administrative appeal encompassing designated business information when:

(1) The information has been designated in good faith by the submitter as confidential commercial information deemed protected from disclosure under Section 792.3(a)(4); or

(2) NCUA has reason to believe that the information may be protected from disclosure under Section 792.3(a)(4).

This notice will afford the submitter an opportunity to object to disclosure pursuant to paragraph (e) of this section. A copy of the notice shall also be provided to the FOIA requester.

(e) Opportunity to object to disclosure—Through the notice described in paragraph (d) of this Section, NCUA shall afford a submitter a reasonable period of time within which to provide a detailed written statement of any objection to disclosure. Such statement shall describe why the information is confidential commercial information and should not be disclosed.

(f) Notice of intent to disclose—Whenever NCUA decides to disclose confidential commercial information over the objection of a submitter, it shall forward to the submitter and to the requester, within a reasonable number of days prior to the specified disclosure date, a written notice which shall include:

(1) A statement of the reasons for which the submitter's disclosure objection was not sustained;

(2) A description of the information to be disclosed; and

(3) A specified disclosure date.

(g) Notice of lawsuit—If a requester brings suit seeking to compel disclosure of confidential commercial information, NCUA shall promptly notify the submitter.

(h) Exceptions to notice requirements—The notice requirements of paragraph (d) of this section do not apply if:

(1) NCUA determines that the information should not be disclosed;

(2) The information lawfully has been published or has been officially made available to the public;

(3) Disclosure of the information is required by law; or

(4) The designation made by the submitter in accordance with paragraph (c) of this Section appears obviously frivolous; except that, in such case, NCUA shall provide the submitter with written notice of any final administrative decision to disclose the information within a reasonable number of days prior to a specified disclosure date.

Subpart B—The Privacy Act

§ 792.20 Scope.

This Subpart governs requests made of NCUA under the Privacy Act (5 U.S.C. § 552a). The regulation applies to all records maintained by NCUA which contain personal information about an individual and some means of identifying the individual, and which are contained in a system of records from which information may be retrieved by use of an identifying particular; sets forth procedures whereby individuals may seek and gain access to records concerning themselves and request amendments of those records; and sets forth requirements applicable to NCUA employees' maintaining, collecting, using, or disseminating such records.

§ 792.21 Definitions.

For purposes of this Subpart:

(a) "Individual" means a citizen of the United States or an alien lawfully admitted for permanent residence.

(b) "Maintain" includes maintain, collect, use, or disseminate.

(c) "Record" means any item, collection, or grouping of information about an individual that is maintained by NCUA, and that contains the name, or an identifying number, symbol, or other identifying particular assigned to the individual.

(d) "System of records" means a group of any records under NCUA's control from which information is retrieved by the name of the individual

or by some identifying number, symbol, or other identifying particular assigned to the individual.

(e) "Routine use" means, with respect to the disclosure of a record, the use of such record for a purpose which is compatible with the purpose for which it was collected.

(f) "Statistical record" means a record in a system of records maintained for statistical research or reporting purposes only and not used in whole or in part in making any determination about an identifiable individual, except as provided by Section 8 of Title 13 of the United States Code.

§ 792.22 Procedures for requests pertaining to individual records in a system of records.

(a) An individual seeking notification of whether a system of records contains a record pertaining to that individual, or an individual seeking access to information or records pertaining to that individual which are available under the Privacy Act shall present a request to the NCUA official identified in the access procedure section of the "Notice of Systems of Records" published in the *FEDERAL REGISTER* which describes the system of records to which the individual's request relates. An individual who does not have access to the *FEDERAL REGISTER* and who is unable to determine the appropriate official to whom a request should be submitted may submit a request to the Director of the Office of Administration, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428, in which case the request will then be referred to the appropriate NCUA official and the date of receipt of the request will be determined as the date of receipt by the official.

(b) In addition to meeting the identification requirements set forth in § 792.23, an individual seeking notification or access, either in person or by mail, shall describe the nature of the record sought, the approximate dates covered by the record, and the system in which it is thought to be included, as described in the "Notice of Systems of Records" published in the *FEDERAL REGISTER*.

§ 792.23 Times, places, and requirements for identification of individuals making requests and identification of records requested.

(a) The following standards are applicable to an individual submitting requests either in person or by mail under § 792.22:

(1) If not personally known to the NCUA official responding to the request, an individual seeking access to records about that individual in person shall establish identity by the presentation of a single document bearing a photograph (such as a passport or identification badge) or by the presentation of two items of identification which do not bear a photograph but do bear both a name and address (such as a driver's license or credit card);

(2) An individual seeking access to records about that individual by mail may establish identity by a signature, address, date of birth, employee identification number if any, and one other identifier such as a photocopy of driver's license or other document. If less than all of this requisite identifying information is provided, the NCUA official responding to the request may require further identifying information prior to any notification or responsive disclosure.

(3) An individual seeking access to records about that individual by mail or in person, who cannot provide the required documentation or identification, may provide a notarized statement affirming identity and recognition of the penalties for false statements pursuant to 18 U.S.C. 1001.

(b) The parent or guardian of a minor or a person judicially determined to be incompetent shall, in addition to establishing identity of the minor or other person as required in paragraph (a) of this section, furnish a copy of a birth certificate showing parentage or a court order establishing guardianship.

(c) An individual may request by telephone notification of the existence of and access to records about that individual and contained in a system of records. In such a case, the NCUA official responding to the request shall require, for the purpose of comparison and verification of identity, at least two items of identifying information (such as date of birth, home address, social security number) already possessed by the NCUA. If the requisite identifying information is not provided, or otherwise at the discretion of the responsible NCUA official, an individual may be required to submit the request by mail or in person in accordance with paragraph (a) of this Section.

(d) An individual seeking to review records about that individual may be accompanied by another person of their own choosing. In such cases,

the individual seeking access shall be required to furnish a written statement authorizing discussion of that individual's records in the accompanying person's presence.

(e) In addition to the requirements set forth in paragraphs (a), (b) and (c) of this Section, the published "Notice of Systems of Records" for individual systems may include further requirements of identification where necessary to retrieve the individual records from the system.

§ 792.24 Notice of existence of records, access decisions and disclosure of requested information; time limits.

(a) The NCUA official identified in the record access procedure section of the "Notice of Systems of Records" and identified in accordance with § 792.22(a), by an individual seeking notification of, or access to, a record, shall be responsible: (1) for determining whether access is available under the Privacy Act; (2) for notifying the requesting individual of that determination; and (3) for providing access to information determined to be available. In the case of an individual access request made in person, information determined to be available shall be provided by allowing a personal review of the record or portion of a record containing the information requested and determined to be available, and the individual shall be allowed to have a copy of all or any portion of available information made in a form comprehensible to him. In the case of an individual access request made by mail, information determined to be available shall be provided by mail, unless the individual has requested otherwise.

(b) The following time limits shall be applicable to the required determinations, notification and provisions of access set forth in paragraph (a) of this Section:

(1) A request concerning a single system of records which does not require consultation with or requisition of records from another agency shall be responded to within 10 working days after receipt of the request;

(2) A request requiring requisition of records from or consultation with another agency shall be responded to within 10 working days after such requisition or resolution of the required consultation. Such required requisition or consultation shall be initiated within 10 working days after receipt of the request;

(3) If a request under paragraphs (b)(1) or (2) of this Section presents unusual difficulties in determining whether the records involved are exempt from disclosure, the Director of the Office of Administration may, upon written request of the official responsible for action upon the record request, extend the time period established by these regulations for an additional 15 working days.

(c) Nothing in this Section shall be construed to allow an individual access to any information compiled in reasonable anticipation of a civil action or proceeding, or any information exempted from the access provisions of the Privacy Act.

§ 792.25 Special procedures: Information furnished by other agencies; medical records.

(a) When a request for records or information from NCUA includes information furnished by other Federal agencies, the NCUA official responsible for action on the request shall consult with the appropriate agency prior to making a decision to disclose or refuse access to the record, but the decision whether to disclose the record shall be made in the first instance by the NCUA official.

(b) When an individual requests medical records concerning that individual, the NCUA official responsible for action on the request may advise the individual that the records will be provided only to a physician designated in writing by the individual. Upon receipt of the designation and upon proper verification of identity, the NCUA official shall permit the physician to review the records or to receive copies of the records by mail. The determination of which records should be made available directly to the individual and which records should not be disclosed directly because of possible harm to the individual shall be made by the NCUA official responsible for action on the request.

§ 792.26 Requests for correction or amendment to a record; administrative review of requests.

(a) An individual may request amendment of a record concerning that individual by addressing a request, either in person or by mail, to the NCUA official identified in the "contesting record procedures" section of the "Notice of Systems of

Records" published in the *FEDERAL REGISTER* and describing the system of records which contains the record sought to be amended. The request must indicate the particular record involved, the nature of the correction sought, and the justification for the correction or amendment. Requests made by mail should be addressed to the responsible NCUA official at the address specified in the "Notice of Systems of Records" describing the system of records which contains the contested record. An individual who does not have access to the NCUA's "Notice of Systems of Records," and to whom the appropriate address is otherwise unavailable may submit a request to the Director of the Office of Administrattion, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428, in which case the request will then be referred to the appropriate NCUA official. The date of receipt of the request will be determined as of the date of receipt by that official.

(b) Within 10 working days of receipt of the request, the appropriate NCUA official shall advise the individual that the request has been received. The appropriate NCUA official shall then promptly (under normal circumstances, not later than 30 working days after receipt of the request) advise the individual that the record is to be amended or corrected, or inform the individual of rejection of the request to amend the record, the reason for the rejection, and the procedures established by § 792.27 for the individual to request a review of that rejection.

§ 792.27 Appeal of initial determination.

(a) A rejection, in whole or in part, of a request to amend or correct a record may be appealed to the General Counsel within 30 working days of receipt of notice of the rejection. Appeals shall be in writing, and shall set forth the specific item of information sought to be corrected and the documentation justifying the correction. Appeals shall be addressed to the Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. Appeals shall be decided within 30 working days of receipt unless the General Counsel, for good cause, extends such period for an additional 30 working days.

(b) Within the time limits set forth in paragraph (a) of this Section, the General Counsel shall either advise the individual of a decision to amend or correct the record, or advise the individual of a determination that an amendment or correction is not warranted on the facts, in which case the individual shall be advised of the right to provide for the record a "Statement of Disagreement" and of the right to further appeal pursuant to the Privacy Act. For records under the jurisdiction of the Office of Personnel Management, appeals will be made pursuant to that agency's regulations.

(c) A statement of disagreement may be furnished by the individual. The statement must be sent, within 30 days of the date of receipt of the notice of General Counsel refusal to authorize correction, to the General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428. Upon receipt of a statement of disagreement in accordance with this Section, the General Counsel shall take steps to ensure that the statement is included in the system of records containing the disputed item and that the original item is so marked to indicate that there is a statement of dispute and where, within the system of records, that statement may be found.

(d) When a record has been amended or corrected or a statement of disagreement has been furnished, the system manager for the system of records containing the record shall, within 30 days thereof, advise all prior recipients of information to which the amendment or statement of disagreement relates whose identity can be determined by an accounting made as required by the Privacy Act of 1974 or any other accounting previously made, of the amendment or statement of disagreement. When a statement of disagreement has been furnished, the system manager shall also provide any subsequent recipient of a disclosure containing information to which the statement relates with a copy of the statement and note the disputed portion of the information disclosed. A concise statement of the reasons for not making the requested amendment may also be provided if deemed appropriate.

(e) If access is denied because of an exemption, the individual shall be notified of the right to appeal that determination to the General Counsel within 180 days after receipt of the determination. Such an appeal shall be determined within 30 days.

§ 792.28 Disclosure of record to person other than the individual to whom it pertains.

No record or item of information concerning an individual which is contained in a system of records maintained by NCUA shall be disclosed

by any means of communication to any person, or to another agency, without the prior written consent of the individual to whom the record or item of information pertains, unless the disclosure would be—

(a) To an employee of the NCUA who has need for the record in the performance of duty;

(b) Required by the Freedom of Information Act;

(c) For a routine use as described in the "Notice of Systems of Records," published in the *FEDERAL REGISTER*, which describes the system of records in which the record or item of information is contained;

(d) To the Bureau of the Census for purposes of planning or carrying out a census or survey or related activity pursuant to the provisions of Title 13 of the United States Code;

(e) To a recipient who has provided the NCUA with advance adequate written assurance that the record or item will be used solely as a statistical research or reporting record, and the record is to be transferred in a form that is not individually identifiable;

(f) To the National Archives and Records Administration as a record or item which has sufficient historical or other value to warrant its continued preservation by the United States Government, or for evaluation by the Archivist of the United States or the designee of the Archivist to determine whether the record has such value;

(g) To another agency or to an instrumentality of any governmental jurisdiction within or under the control of the United States for a civil or criminal law enforcement activity if the activity is authorized by law, and if the head of the agency or instrumentality has made a written request to NCUA specifying the particular portion desired and the law enforcement activity for which the record or item is sought;

(h) To a person pursuant to a showing of compelling circumstances affecting the health or safety of an individual if, upon such disclosure, notification is transmitted to the last known address of such individual;

(i) To either House of Congress, or, to the extent of matter within its jurisdiction, any committee or subcommittee thereof, any joint committee of Congress or subcommittee of any such joint committee;

(j) To the Comptroller General, or any of his authorized representatives, in the course of the performance of the duties of the General Accounting Office; or

(k) Pursuant to the order of a court of competent jurisdiction; or

(l) To a consumer reporting agency in accordance with Section 3711(f) of Title 31 of the United States Code (31 U.S.C. § 3711(f)).

§ 792.29 Accounting for disclosures.

(a) Each system manager identified in the "Notice of Systems of Records" as published in the *FEDERAL REGISTER* for each system of records maintained by the NCUA, shall establish a system of accounting for all disclosures of information or records concerning individuals and contained in the system of records, made outside NCUA. Accounting procedures may be established in the least expensive and most convenient form that will permit the system manager to advise individuals, promptly upon request, of the persons or agencies to which records concerning them have been disclosed.

(b) Accounting records, at a minimum, shall include the information disclosed, the name and address of the person or agency to whom disclosure was made, and the date of disclosure. When records are transferred to the National Archives and Records Administration for storage in records centers, the accounting pertaining to those records shall be transferred with the records themselves.

(c) Any accounting made under this Section shall be retained for at least five years or the life of the record, whichever is longer, after the disclosure for which the accounting is made.

§ 792.30 Requests for accounting for disclosures.

At the time of the request for access or correction or at any other time, an individual may request an accounting of disclosures made of the individual's record outside the NCUA. Request for accounting shall be directed to the system manager. Any available accounting, whether kept in accordance with the requirements of the Privacy Act or under procedures established prior to September 27, 1975, shall be made available to the individual, except that an accounting need not be made available if it relates to: (a) a disclosure made pursuant to the Freedom of Information Act (5 U.S.C. 552); (b) a disclosure made within the NCUA; (c) a disclosure made to a law enforcement agency pursuant to 5 U.S.C. 552a(b)(7); (d) a disclosure which

has been exempted from the provisions of 5 U.S.C. 552a(c)(3) pursuant to 5 U.S.C. 552a(j) or (k).

§ 792.31 Collection of information from individuals: information forms.

(a) The system manager, as identified in the "Notice of Systems of Records" published in the *FEDERAL REGISTER* for each system of records maintained by the Administration, shall be responsible for reviewing all forms developed and used to collect information from or about individuals for incorporation into the system of records.

(b) The purpose of the review shall be to eliminate any requirement for information that is not relevant and necessary to carry out an NCUA function and to accomplish the following objectives:

(1) To ensure that no information concerning religion, political beliefs or activities, association memberships (other than those required for a professional license), or the exercise of other First Amendment rights is required to be disclosed unless such requirement of disclosure is expressly authorized by statute or is pertinent to and within the scope of any authorized law enforcement activity;

(2) To ensure that the form or accompanying statement makes clear to the individual which information by law must be disclosed and the authority for that requirement, and which information is voluntary;

(3) To ensure that the form or accompanying statement makes clear the principal purpose or purposes for which the information is being collected, and states concisely the routine uses that will be made of the information;

(4) To ensure that the form or accompanying statement clearly indicates to the individual the existing rights, benefits or privileges not to provide all or part of the requested information; and

(5) To ensure that any form requesting disclosure of a social security number, or an accompanying statement, clearly advises the individual of the statute or regulation requiring disclosure of the number, or clearly advises the individual that disclosure is voluntary and that no consequence will flow from a refusal to disclose it, and the uses that will be made of the number whether disclosed mandatorily or voluntarily.

(c) Any form which does not meet the objectives specified in the Privacy Act and this Section shall be revised to conform thereto.

§ 792.32 Contracting for the operation of a system of records.

(a) No NCUA component shall contract for the operation of a system of records by or on behalf of the Agency without the express approval of the NCUA Board.

(b) Any contract which is approved shall continue to ensure compliance with the requirements of the Privacy Act. The contracting component shall have the responsibility for ensuring that the contractor complies with the contract requirements relating to the Privacy Act.

§ 792.33 Fees.

(a) Fees pursuant to 5 U.S.C. 552a(f)(5) shall be assessed for actual copies of records provided to individuals on the following basis, unless the NCUA official determining access waives the fee because of the inability of the individual to pay or the cost of collecting the fee exceeds the fee:

(1) For actual copies of documents, 25 cents per page; and

(2) For copying information, if any, maintained in nondocument form, the direct cost to NCUA may be assessed.

(b) If it is determined that access fees chargeable under this Section will amount to more than $25, and the individual has not indicated in advance willingness to pay fees as high as are anticipated, the individual shall be notified of the amount of the anticipated fees before copies are made, and the individual's access request shall not be considered to have been received until receipt by NCUA of written agreement to pay.

§ 792.34 Exemptions.

(a) NCUA maintains three systems of records which are exempted from some of the provisions of the Privacy Act. In paragraph (b) of this Section, those systems of records are identified by System Name and System Number, as stated in the NCUA's "Notice of Systems of Records," published in the *FEDERAL REGISTER*. The provisions from which each system is exempted and the reasons therefor are also set forth.

(b)(1) System NCUA-1, entitled "Employee Security Investigations Containing Adverse Information," consists of adverse information about NCUA employees which has been obtained as a result of routine Office of Personnel Management Security Investigations. To the extent that NCUA maintains records in this system pursuant to Office of Personnel Management guidelines which require or may require retrieval of information by use of individual identifiers, those records are encompassed by and included in the Office of Personnel Management Government-Wide System of Records Number 4, entitled "Personnel Investigations Records," and thus are subject to the applicable specific exemptions promulgated by the Office of Personnel Management. Additionally, in order to ensure the protection of properly confidential sources, particularly as to those records which are not maintained pursuant to such Office of Personnel Management requirements, the records in these systems of records are exempted, pursuant to Section (k)(5) of the Privacy Act (5 U.S.C. 552a(k)(5)), from Section (d) of the Act (5 U.S.C. 552a(d)). To the extent that disclosure of a record would reveal the identity of a confidential source, NCUA need not grant access to that record by its subject. Information which would reveal a confidential source shall, however, whenever possible, be extracted or summarized in a manner which protects the source and the summary or extract shall be provided to the requesting individual.

(2) System NCUA-4, entitled "Investigative Reports Involving Possible Felonies and/or Violations of the Federal Credit Union Act," consists of a limited number of records about individuals suspected of involvement in felonies or infractions under the Federal Credit Union Act or criminal statutes. These records are maintained in an overall context of general investigative information concerning crimes against credit unions. To the extent that individually identifiable information is maintained, however, for purposes of protecting the security of any investigations by appropriate law enforcement authorities and promoting the successful prosecution of all actual criminal activity, the records in this system are exempted, pursuant to Section k(2) of the Privacy Act (5 U.S.C. 552a (k)(2)), from Sections (c)(3), and (d)). NCUA need not make an accounting of previous disclosures of a record in this system of records available to its subject, and NCUA need not grant access to any records in this system of records by their subject. Further, whenever individuals request records about themselves and maintained in this system of records, the NCUA shall, to the extent necessary to realize the above-stated purposes, neither confirm nor deny the existence of the records but shall advise the individuals only that no records available to them pursuant to the Privacy Act of 1974 have been identified. However, should review of the record reveal that the information contained therein has been used or is being used to deny the individuals any right, privilege or benefit for which they are eligible or to which they would otherwise be entitled under Federal law, the individuals shall be advised of the existence of the information and shall be provided the information, except to the extent disclosure would identify a confidential source. Information which would identify a confidential source shall, if possible, be extracted or summarized in a manner which protects the source and the summary or extract shall be provided to the requesting individual.

(3) System NCUA–20, entitled, "Office of Inspector General (OIG) Investigative Records," consists of OIG records of closed and pending investigations of individuals alleged to have been involved in criminal violations. The records in this system are exempted pursuant to Sections (k)(2) of the Privacy Act, 5 U.S.C. 552a(k)(2), from sections (c)(3); (d); (e)(1); (e)(4)(G); (e)(4)(H); (e)(4)(I); and (f). The records in this system are also exempted pursuant to Section (j)(2) of the Privacy Act, 5 U.S.C. 552a(j)(2), from sections (c)(3); (c)(4); (d); (e)(1); (e)(2); (e)(3); and (g).

(c) For purposes of this Section, a "confidential source" means a source who furnished information to the Government under an express promise that the identity of the source would remain confidential, or, prior to September 27, 1976, under an implied promise that the identity of the source would be held in confidence.

§ 792.35 Security of systems of records.

(a) Each system manager, with the approval of the head of that Office, shall establish administrative and physical controls to ensure the protection of a system of records from unauthorized access or disclosure and from physical damage or destruction. The controls instituted shall be proportional to the degree of sensitivity of the records, but at a minimum must ensure: that records are enclosed

in a manner to protect them from public view; that the area in which the records are stored is supervised during all business hours to prevent unauthorized personnel from entering the area or obtaining access to the records; and that the records are inaccessible during nonbusiness hours.

(b) Each system manager, with the approval of the head of that Office, shall adopt access restriction to insure that only those individuals within the agency who have a need to have access to the records for the performance of duty have access. Procedures shall also be adopted to prevent accidental access to or dissemination of records.

§ 792.36 Use and collection of Social Security numbers.

The head of each NCUA Office shall take such measures as are necessary to ensure that employees authorized to collect information from individuals are advised that individuals may not be required without statutory or regulatory authorization to furnish Social Security numbers, and that individuals who are requested to provide Social Security numbers voluntarily must be advised that furnishing the number is not required and that no penalty or denial of benefits will flow from the refusal to provide it.

§ 792.37 Training and employee standards of conduct with regard to privacy.

(a) The Director of the Office of Administration, with advice from the General Counsel, shall be responsible for training NCUA employees in the obligations imposed by the Privacy Act and this Subpart.

(b) The head of each NCUA Office shall be responsible for assuring that employees subject to that person's supervision are advised of the provisions of the Privacy Act, including the criminal penalties and civil liabilities provided therein, and that such employees are made aware of their responsibilities to protect the security of personal information, to assure its accuracy, relevance, timeliness, and completeness, to avoid unauthorized disclosure either orally or in writing, and to ensure that no information system concerning individuals, no matter how small or specialized, is maintained without public notice.

(c) With respect to each system of records maintained by NCUA, Agency employees shall:

(1) Collect no information of a personal nature from individuals unless authorized to collect it to achieve a function or carry out an NCUA responsibility;

(2) Collect from individuals only that information which is necessary to NCUA functions or responsibilities;

(3) Collect information, wherever possible, directly from the individual to whom it relates;

(4) Inform individuals from whom information is collected of the authority for collection, the purposes thereof, the routine uses that will be made of the information, and the effects, both legal and practical, of not furnishing the information;

(5) Not collect, maintain, use, or disseminate information concerning an individual's religious or political beliefs or activities or his membership in associations or organizations, unless (i) the individual has volunteered such information for his own benefit; (ii) the information is expressly authorized by statute to be collected, maintained, used, or disseminated; or (iii) activities involved are pertinent to and within the scope of an authorized investigation or adjudication;

(6) Advise their supervisors of the existence or contemplated development of any record system which retrieves information about individuals by individual identifier;

(7) Maintain an accounting, in the prescribed form, of all dissemination of personal information outside NCUA, whether made orally or in writing;

(8) Disseminate no information concerning individuals outside NCUA except when authorized by 5 U.S.C. 552a or pursuant to a routine use as set forth in the "routine use" section of the "Notice of Systems of Records" published in the *FEDERAL REGISTER*;

(9) Maintain and process information concerning individuals with care in order to ensure that no inadvertent disclosure of the information is made either within or outside NCUA; and

(10) Call to the attention of the proper NCUA authorities any information in a system maintained by NCUA which is not authorized to be maintained under the provisions of the Privacy Act, including information on First Amendment activities, information that is inaccurate, irrelevant or so incomplete as to risk unfairness to the individuals concerned.

(d) Heads of offices within NCUA shall, at least annually, review the record systems subject to their supervision to ensure compliance with the provisions of the Privacy Act.

Subpart C—Subpoenas

§ 792.40 Service.

Any subpoena or other legal process requesting Agency records shall be served upon the General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428, or upon the Regional Director of the NCUA Region where the legal action from which the legal process issued is pending.

§ 792.41 Advice to person served.

(a) If any NCUA officer, employee or agent is served with a subpoena, court order or other legal process requiring that person's attendance as a witness concerning written information or the production of documents that may not be disclosed under § 792.3, that person should promptly inform the Office of General Counsel of such service and of all relevant facts, including the nature of the documents and information sought in the subpoena and any facts and circumstances which may be of assistance to the Office of General Counsel in determining whether such documents or information should be produced.

(b) If any third party who is not an NCUA officer, employee or agent is served with a subpoena, court order or other legal process requiring that party to produce such records or to testify with respect to the requested records, such party should notify the Office of General Counsel in accordance with the procedures set forth in § 792.41(a).

§ 792.42 Appearance by person served.

Except by authorization of the Office of General Counsel to disclose the requested information, any NCUA officer, employee or agent (and any third party having custody of exempt records of the Administration) who is required to respond to the subpoena or other legal process shall attend at the time and place specified and shall respectfully decline to produce the documents and records or to disclose the information called for, basing his refusal upon this paragraph.

Subpart D—Security Procedures for Classified Information

§ 792.50 Program.

(a) The Director of the Office of Administration, ("Director") is designated as the person responsible for implementation and oversight of NCUA's program for maintaining the security of confidential information regarding national defense and foreign relations. The Director receives questions, suggestions and complaints regarding all elements of this program. The Director is solely responsible for changes to the program and assures that the program is consistent with legal requirements.

(b) The Director is the Agency's official contact for declassification requests regardless of the point of origin of such requests. The Director is also responsible for assuring that requests submitted under the Freedom of Information Act are handled in accordance with that Act and other applicable law.

§ 792.51 Procedures.

(a) *Mandatory review.* All declassification requests made by a member of the public, by a government employee or by an agency shall be handled by the Director or the Director's designee. Under no circumstances shall the Director refuse to confirm the existence or nonexistence of a document under the Freedom of Information Act or the mandatory review provisions of other applicable law, unless the fact of its existence or nonexistence would itself be classifiable under applicable law. Although NCUA has no authority to classify or declassify information, it occasionally handles information classified by another agency. The Director shall refer all declassification requests to the agency that originally classified the information. The Director or the Director's designee shall notify the requesting person or agency that the request has been referred to the originating agency and that all further inquiries and appeals must be made directly to the other agency.

(b) *Handling and safeguarding national security information.* All information classified "Top Secret," "Secret," and "Confidential" shall be delivered to the Director or the Director's designee immediately upon receipt. The Director shall advise those who may come into possession of such information of the name of the current designee. If the Director is unavailable, the designee shall lock

the documents, unopened, in the combination safe located in the Administrative Office. If the Director or the designee is unavailable to receive such documents, the documents shall be delivered to the Director of the Personnel Office who shall lock them, unopened, in the combination safe in the Personnel Office. Under no circumstances shall classified materials that cannot be delivered to the Director be stored other than in the two designated safes.

(c) *Storage.* All classified documents shall be stored in the combination safe located in the Director's Office, except as provided in paragraph (b) of this Section. The combination shall be known only to the Director and the Director's designee holding the proper security clearance.

(d) *Employee Education*. The Director shall send a memo to every NCUA employee who (1) has a security clearance and (2) may handle classified materials. This memo shall describe NCUA procedures for handling, reproducing and storing classified documents. The Director shall require each such employee to review Executive Order 12356.

(e) *Agency Terminology*. The National Credit Union Administration's Central Office shall use the terms "Top Secret," "Secret" or "Confidential" only in relation to materials classified for national security purposes.

Part 793

Tort Claims Against The Government

Subpart A—General

§ 793.1 Scope of regulations.

The regulations in this Part shall apply only to claims asserted under the Federal Tort Claims Act, as amended, 28 U.S.C. Sections 2671–2680, accruing on or after January 18, 1967, for money damages against the United States for damage to or loss of property or personal injury or death caused by the negligent or wrongful act or omission of any employee of the National Credit Union Administration while acting within the scope of his office of employment.

Subpart B—Procedures

§ 793.2 Administrative claim; when presented; place of filing.

(a) For purposes of the regulations in this Part, a claim shall be deemed to have been presented when the National Credit Union Administration receives, at a place designated in paragraph (c) of this Section, an executed Standard Form 95 or other written notification of an incident accompanied by a claim for money damages in a sum certain for damage to or loss of property, for personal injury, or for death, alleged to have occurred by reason of the incident. A claim which should have been presented to the National Credit Union Administration but which was mistakenly addressed to or filed with another Federal agency, shall be deemed to be presented to the National Credit Union Administration as of the date that the claim is received by the National Credit Union Administration. A claim mistakenly addressed to or filed with the National Credit Union Administration shall forthwith be transferred to the appropriate Federal agency, if ascertainable, or returned to the claimant.

(b) A claim presented in compliance with paragraph (a) of this Section may be amended by the claimant at any time prior to final action by the Office of General Counsel, National Credit Union Administration or prior to the exercise of the claimant's option to bring suit under 28 U.S.C. 2675(a). Amendments shall be submitted in writing and signed by the claimant or his duly authorized agent or legal representative. Upon the timely filing of an amendment to a pending claim, the National Credit Union Administration shall have 6 months in which to make a final disposition of the claim as amended and the claimant's option under 28 U.S.C. 2675(a) shall not accrue until 6 months after the filing of an amendment.

(c) Forms may be obtained and claims may be filed with the regional office of the National Credit Union Administration having jurisdiction over the employee involved in the accident or incident, or with the Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

§ 793.3 Administrative claim; who may file.

(a) A claim for injury to or loss of property may be presented by the owner of the property interest which is the subject matter of the claim, his duly authorized agent, or his legal representative.

(b) A claim for personal injury may be presented by the injured person, his duly authorized agent, or his legal representative.

(c) A claim based on death may be presented by the executor or administrator of the decedent's estate or by any other person legally entitled to assert such a claim under applicable state law.

(d) A claim for loss wholly compensated by an insurer with the rights of a subrogee may be presented by the insurer. A claim for loss partially compensated by an insurer with the rights of a subrogee may be presented by the insurer or the insured individually, as their respective interests appear, or jointly. Whenever an insurer presents a claim asserting the rights of a subrogee, he shall present with his claim appropriate evidence that he has the rights of a subrogee.

(e) A claim presented by an agent or legal representative shall be presented in the name of the claimant, be signed by the agent or legal representative, show the title or legal capacity of the person signing, and be accompanied by evidence

of his authority to present a claim on behalf of the claimant as agent, executor, administrator, parent, guardian, or other representative.

§ 793.4 Administrative claim; evidence and information to be submitted.

(a) *Death.* In support of a claim based on death, the claimant may be required to submit the following evidence or information:

(1) An authenticated death certificate or other competent evidence showing the cause of death, date of death, and age of the decedent.

(2) Decedent's employment or occupation at the time of death, including his monthly or yearly salary or earnings (if any), and the duration of his last employment or occupation.

(3) Full names, addresses, birthdates, kinship, and marital status of the decedent's survivors, including those survivors who were dependent for support upon the decedent at the time of his death.

(4) Degree of support afforded by the decedent to each survivor dependent upon him for support at the time of his death.

(5) Decedent's general physical and mental condition before death.

(6) Itemized bills for medical and burial expenses incurred by reason of the incident causing death, or itemized receipts of payments for such expenses.

(7) If damages for pain and suffering before death are claimed, a physician's detailed statement specifying the injuries suffered, duration of pain and suffering, any drugs administered for pain and the decedent's physical condition in the interval between injury and death.

(8) Any other evidence or information which may have a bearing on the responsibility of the United States for the death or the damages claimed.

(b) *Personal injury.* In support of a claim based on personal injury, the claimant may be required to submit the following evidence or information: (1) A written report by his attending physician or dentist setting forth the nature and extent of the injury, nature and extent of the treatment, any degree of temporary or permanent disability, the prognosis, period of hospitalization, and any diminished earning capacity. In addition, the claimant may be required to submit to a physical and/or mental examination by a physician employed or designated by the National Credit Union Administration. A copy or report of the examining physician shall be made available to the claimant upon the claimant's written request provided that claimant has, upon request, furnished the report referred to in the first sentence of this subparagraph and has made or agrees to make available to the National Credit Union Administration any other physician's reports previously or thereafter made of the physical or mental condition which is the subject of his claim.

(2) Itemized bills for medical, dental, and hospital expenses incurred, or itemized receipts of payment for such expenses.

(3) If the prognosis reveals the necessity for future treatment, a statement of expected duration of and expenses for such treatment.

(4) If a claim is made for loss of time from employment, a written statement from his employer showing actual time lost from his employment, whether he is a full or part time employee, and wages or salary actually lost.

(5) If a claim is made for loss of income and the claimant is self-employed, documentary evidence showing the amount of earnings actually lost.

(6) Any other evidence or information which may have a bearing on the responsibility of the United States for the personal injury or the damages claimed.

(c) *Property damage.* In support of a claim for damages to or loss of property, real or personal, the claimant may be required to submit the following information or evidence:

(1) Proof of ownership.

(2) A detailed statement of the amount claimed with respect to each item of property.

(3) An itemized receipt of payment for necessary repairs or itemized written estimates of the cost of such repairs.

(4) A statement listing date of purchase, purchase price, market value of the property as of date of damage, and salvage value, where repair is not economical.

(5) Any other evidence or information which may have a bearing on the responsibility of the United States for the injury to or loss of property or the damages claimed.

(d) *Time limit.* All evidence required to be submitted by this Section shall be furnished by the claimant within a reasonable time. Failure of a claimant to furnish evidence necessary for a determination of his claim within 3 months after a request therefor has been mailed to his last known

address may be deemed an abandonment of the claim. The claim may be thereupon disallowed.

§ 793.5 Investigation, examination, and determination of claims.

When a claim is received, the constituent agency out of whose activities the claim arose shall make such investigation as may be necessary or appropriate for a determination of the validity of the claim and thereafter shall forward the claim, together with all pertinent material, and a recommendation based on the merits of the case, with regard to the allowance or disallowance of the claim, to the Office of General Counsel, National Credit Union Administration to whom authority has been delegated to adjust, determine, compromise and settle all claims hereunder.

§ 793.6 Final denial of claim.

(a) Final denial of an administrative claim shall be in writing and sent to the claimant, his attorney, or legal representative by certified or registered mail. The notification of final denial may include a statement of the reasons for the denial and shall include a statement that, if the claimant is dissatisfied with the action of the National Credit Union Administration, he may file suit in an appropriate U.S. District Court not later than 6 months after the date of mailing the notification.

(b) Prior to the commencement of suit and prior to the expiration of the 6-month period after the date of mailing, by certified or registered mail of notice of final denial of the claim as provided in 28 U.S.C. 2401(b), a claimant, his duly authorized agent, or legal representative, may file a written request with the National Credit Union Administration for reconsideration of a final denial of a claim under paragraph (a) of this Section. Upon the timely filing of a request for reconsideration the National Credit Union Administration shall have 6 months from the date of filing in which to make a final disposition of the claim and the claimant's option under 28 U.S.C. 2675(a) to bring suit shall not accrue until 6 months after the filing of a request for reconsideration. Final National Credit Union Administration action on a request for reconsideration shall be effected in accordance with the provisions of paragraph (a) of this Section.

§ 793.7 Payment of approved claims.

(a) Upon allowance of his claim, claimant or his duly authorized agent shall sign the voucher for payment, Standard Form 1145, before payment is made.

(b) When the claimant is represented by an attorney, the voucher for payment (S.F. 1145) shall designate both the claimant and his attorney as "payees." The check shall be delivered to the attorney whose address shall appear on the voucher.

§ 793.8 Release.

Acceptance by the claimant, his agent or legal representative, of any award, compromise or settlement made hereunder, shall be final and conclusive on the claimant, his agent or legal representative and any other person on whose behalf or for whose benefit the claim has been presented, and shall constitute a complete release of any claim against the United States and any employee of the Government whose act or omission gave rise to the claim, by reason of the same subject matter.

§ 793.9 Penalties.

A person who files a false claim or makes a false or fraudulent statement in a claim against the United States may be liable to a fine of not more than $10,000 or to imprisonment of not more than 5 years, or both (18 U.S.C. 287–1001), and, in addition, to a forfeiture of $2,000 and a penalty of double the loss or damage sustained by the United States (31 U.S.C. 231).

§ 793.10 Limitation on National Credit Union Administration's authority.

(a) An award, compromise or settlement of a claim hereunder in excess of $25,000 shall be effected only with the prior written approval of the Attorney General or his designee. For purposes of this paragraph, a principal claim and any derivative or subrogated claim shall be treated as a single claim.

(b) An administrative claim may be adjusted, determined, compromised or settled hereunder only after consultation with the Department of Justice when, in the opinion of the National Credit Union Administration:

(1) A new precedent or a new point of law is involved; or

(2) A question of policy is or may be involved; or

(3) The United States is or may be entitled to indemnity or contribution from a third party and the National Credit Union Administration is unable to adjust the third party claim; or

(4) The compromise of a particular claim, as a practical matter, will or may control the disposition of a related claim in which the amount to be paid may exceed $25,000.

(c) An administrative claim may be adjusted, determined, compromised or settled only after consultation with the Department of Justice when it is learned that the United States or any employee, agent or cost-plus contractor of the United States is involved in litigation based on a claim arising out of the same incident or transaction.

Part 794

Enforcement of Nondiscrimination on the Basis of Handicap in Federally Conducted Programs

This regulation requires the NCUA operate all of its programs and activities to ensure nondiscrimination against qualified handicapped persons. It sets forth standards for what constitutes discrimination on the basis of mental or physical handicap, provides a definition for handicapped person and qualified handicapped person, and establishes a complaint mechanism for resolving allegations of discrimination. This regulation is issued under the authority of Section 504 of the Rehabilitation Act of 1973, as amended, which prohibits discrimination on the basis of handicap in programs or activities conducted by Federal executive agencies.

The regulation will not be reprinted here because of its length and the fact that it is not applicable to credit unions. If a copy is desired, it may be obtained by writing to: Office of Administration, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

Part 795

OMB Control Numbers Assigned Pursuant to The Paperwork Reduction Act

§ 795.1 OMB control numbers.

(a) *Purpose.* This subpart collects and displays the control numbers assigned to information collection requirements of the NCUA by the Office of Management and Budget (OMB) pursuant to the Paperwork Reduction Act of 1980, Pub. L. 96–511. The NCUA intends to comply with the requirements of section 3507(f) of the Paperwork Reduction Act, which requires that agencies display a current control number assigned by the Director of OMB for each agency information collection requirement.

(b) *Display.*

12 CFR part or section where identified and described	Current OMB control no.
701.1	3133–0015
701.12	3133–0075
701.13	3133–0053
701.21	3133–0092
	3133–0101
	3133–0110
701.31	3133–0068
701.36	3133–0040
702.2	3133–0072
705	3133–0109
708	3133–0024
708	3133–0107
710	3133–0076
724.1	3133–0035
725	3133–0060
	3133–0061
	3133–0063
	3133–0064
740.2	3133–0098
741	3133–0004
	3133–0009
	3133–0011
	3133–0099
	3133–0106
748	3133–0033
	3133–0094
	3133–0108
749	3133–0032

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Supervisory Committee Audits and Verifications

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is amending its regulations governing credit union supervisory committee audits and verifications. The final amendments clarify existing audit scope; expand audit scope and reporting requirements for compensated auditors only; require a comprehensive engagement letter setting forth minimum contracting terms and conditions; clarify existing working paper access requirements; expressly state available administrative sanctions for failure to comply with supervisory committee audit requirements and working paper access requirements; and add relevant definitions of accounting/auditing terms use throughout the regulation.

EFFECTIVE DATE: December 31, 1996.

FOR FURTHER INFORMATION CONTACT: Karen Kelbly, Accounting Officer, Office of Examination and Insurance (703) 518–6360, or Michael McKenna, Attorney, Office of General Counsel (703) 518–6540, at 1775 Duke Street, Alexandria, Virginia 22314–3428.

SUPPLEMENTARY INFORMATION:

A. Background

Section 701.12 of NCUA's Regulations sets forth the supervisory committee's responsibility in meeting the audit and verification requirements of section 115 of the Federal Credit Union Act, 12 U.S.C. § 1761d. A supervisory committee audit is required at least once every calendar year covering the period since the last audit. The scope of the audit must be sufficient, at a minimum, to test the federal credit union's assets, liabilities, equity, income, and expenses for existence, proper cut off, valuations, ownership, disclosures and classification, and internal controls. Section 741.202 of NCUA's Rules and Regulations, 12 CFR 741.12, make these requirements applicable to federally insured state-chartered credit unions.

NCUA continues to have concerns with the scope of the supervisory committee audit and with access to working papers supporting such audits. The Board felt there was a need to amend the regulation because:

- Many supervisory committee audits have been inadequate;
- Examiners have been placed in the position of brokering disputes between external auditors and supervisory committees relative to audit inadequacy;
- The standards supervisory committee have been held to are not definitive;
- Examiner access to ''proprietary working papers'' has been limited;
- Greater uniformity in audit scope is needed; and
- The addition of definitions is needed to enhance clarity.

Consequently, on October 19, 1995, the Board issued proposed amendments to the regulation governing credit union supervisory committee audits and verifications (Section 701.12 of NCUA's Regulations) 60 F.R. 55663 (November 2, 1995). On December 19, 1995, the Board extended the comment period to January 18, 1996. 60 F.R. 66952 (December 27, 1995). The proposed amendments: (1) clarified existing audit scope; (2) expanded audit scope and reporting requirements for compensated auditors only; (3) required a comprehensive engagement letter setting forth minimum contracting terms and conditions; (4) clarified existing working paper access requirements; (5) expressly stated available administrative sanctions for failure to comply with supervisory committee audit requirements and working paper access requirements; and (6) added relevant definitions of accounting/auditing terms used throughout the regulation.

B. Comments

One hundred and eighteen comments were received. Comments were received from sixty-nine federal credit unions, nine state chartered credit unions, twenty-one state leagues, four national credit union trade associations, eleven certified public accounting firms, one internal auditor, one certified public accountant trade organization, and one government agency. NCUA also received one anonymous electronic mail.

Eight commenters express complete support for the proposal. Fifteen commenters oppose the entire proposal. Twelve of these commenters believe that the current system is working well and that the proposed amendments will simply result in increased costs without any increased service. Ninety-seven commenters express varied levels of support for the proposal; however, most of these commenters had one or more objections to the proposal. A recurring theme among these commenters was that the proposal would hurt small credit unions. Another recurring theme was that the proposed amendments, in effect, require an opinion audit. Finally, a number of commenters believe the proposed amendments would increase costs to credit unions.

The Board believes the final regulation reasonably balances the concerns of those opposing additional burden for small credit unions with the need for complete and reliable credit union audits. The Board appreciates the obstacles small credit unions face when operating in today's environment and does not wish to add to that burden unnecessarily. The amendments to this regulation will not have a significant impact on a credit union which meets its supervisory committee audit obligations in any of the following ways:

- The credit union's supervisory committee performs the audit itself.
- The credit union's internal auditor performs the audit.
- The supervisory committee recruits a member or volunteer who performs the audit (i.e., the member or volunteer is not in the business of performing compensated audits for credit unions).
- The supervisory committee obtains an opinion audit.

If the supervisory committee itself or its uncompensated designated representative performs the supervisory committee audit as prescribed in § 701.12(c)(5)(i)(D), the following portions of the proposed regulation *will not apply* to the supervisory committee audit:

- § 701.12(c)(4)—Increased scope requirements in designated areas;
- § 701.12(c)(5)(i)(A–C)—Opinion audits and agreed-upon procedures in relation to compensated auditors; and
- § 701.12(d)—Engagement letter requirements.

Additionally, NCUA will revise its *Supervisory Committee Guide for Federal Credit Unions* for targeted release prior to December 31, 1996. The revised Guide will provide guidance to assist a supervisory committee itself or its uncompensated designated representative in meeting the applicable requirements of this regulation.

If the supervisory committee employs an auditor who is defined as a ''compensated auditor'' to perform (or assist in performing) the audit, the following additional requirements will be necessary:

- An engagement letter between the credit union and the compensated auditor;
- Expanded audit scope in certain areas if the compensated auditor is engaged to address, and agrees to take on, these areas; and
- Notification in writing of reportable conditions or errors and irregularities, if any, discovered in the normal course of the audit.

Requirement addressed	SC Audit performed by	
	Supervisory committee or designated non-compensated auditor	Compensated auditor
Engagement Letter	No engagement letter requirement	Engagement letter required.
Scope	As exists under current regulation	As exists under current regulation, *plus* expanded scope in *identified* areas.[1]
Testing/Procedures Performed in Accordance With.	Regulation identifies specific standards which apply.	Regulation identifies specific standards which apply.
Reporting Standards	As exists under current regulation	As exists under current regulation, *plus* ''reportable conditions,'' if any, and ''errors and irregularities,'' if any, simply ''reduced to writing''.[1]

[1] Distinguishable from an opinion audit because the following are *not* required: full scope of opinion audit, financial statements, related disclosures, auditor's opinion, or negative assurance.

Comments Relating to Current § 701.12. Throughout the comment letters of accounting/auditing professionals were a series of comments addressing conditions which apply equally to the current and to the revised § 701.12. These include:

1. Auditing work should not be performed by lay individuals; CPAs alone have the professional proficiency to perform audits.

2. The proposed regulations put CPAs at an economic disadvantage to compete in the credit union marketplace. A CPA performing a supervisory committee audit would be bound by the professional auditing standards promulgated by AICPA and the State Board of Accountancy, while a non-CPA is not so burdened. CPA would not be able to charge fees competitive with (i.e., as low as) that of non-CPA.

3. CPAs are concerned about the ability of non-CPA examiners to review CPA's work.

4. CPAs may limit themselves to performing only opinion audits for credit unions. A new auditing standard, Statement of Auditing Standard (SAS) No. 75, governing agreed-upon procedures engagements requires users of agreed-upon procedures reports to acknowledge the sufficiency of such procedures in satisfying the requirements of the specified user. If the CPA cannot get the specified user to do this (in advance of the engagement), then the only work a CPA could perform for a specified user would be an opinion audit. The thrust of this comment is that NCUA would qualify as a ''specified user'' and would, therefore, have to acknowledge the sufficiency of the procedures prior to each credit union's engagement of a CPA.

Each of these comments applies equally to the current regulation and the amended version being issued as a final rule; they are not exacerbated by the amendments. The source of some of the conditions addressed in the comments is not, if fact, any action by NCUA, but rather, exists due to the actions of others. The first three conditions, which we will address first, are relatively straight-forward; the SAS No. 75 issue is more complex and is addressed in section K.

The first condition will exist as long as NCUA allows auditors other than licensed, independent certified public accountants to perform supervisory committee audits. Since the NCUA Board is committed to allowing credit union supervisory committees the option to engage non-CPA accounting/auditing professionals, there can be no ready resolution of this concern either under the current or the amended final regulation.

As to the second area of concern, that CPAs are bound by professional standards imposed by state licensing authorities and by the AICPA (e.g., education, proficiency, peer review, AICPA professional ethics, GAAS, etc.), while non-CPAs are not, this is not the result of any additional requirements imposed by NCUA. The NCUA Board has no jurisdiction over the imposition of auditing standards governing the work of CPAs. The only way to ''regulate away'' the purported ''economic disadvantage'' the CPAs would be to limit the performance of supervisory committee audits to licensed, independent certified public accountants. This would create an ''economic disadvantage'' as to all other types of auditors, particularly those who audit small credit unions. The NCUA Board does not believe this is a viable solution.

Third, examiners review the work of compensated auditors for compliance with this section. Wherein such examination requires the non-CPA examiner to review compensated auditor's work for compliance with GAAS and a deficiency is suspected, NCUA recognizes it is not an authority on GAAP or GAAS. Referral to state accountancy licensing authorities or the AICPA Ethics Division, where applicable, will be NCUA's means of seeking assistance to make such determinations. NCUA is sympathetic to the argument that non-CPAs do not have the knowledge and proficiency necessary to determine the extent of substantive testing required under GAAS, but it believes they can do so under this section which is a lesser, and regulatory defined, standard.

As to the fourth area of comment, this area is somewhat more perplexing. We have discussed SAS No. 75 and related issues in section K. Suffice it to say here that this condition exists as a result of the new auditing standard promulgated by auditing standards-setters which became effective May 1, 1996. The condition exists under the current regulation and was not created or aggravated by any NCUA effort to amend this regulation. The timing of the SAS No. 75 effective date and NCUA's efforts to revise this part are coincidental.

Areas Seemingly Misunderstood. The comment relative to ''burden on small credit unions'' are believed to have resulted primarily from a misunderstanding of the proposed amendments. Such comments made include:

- The regulations essentially require an opinion audit.
- Audit scope will have to be expanded substantially to generate the two additional reports required.
- Working paper access requirements will generate increased travel and credit union staff costs.

Each of these areas are discussed at length below.

C. Definitions

The proposal added a set of definitions for terms used in the regulation. Many of these terms, while familiar to accounting/auditing professionals, may be less well know to supervisory committee volunteers. The proposed definitions included: (1) Agreed-upon procedures; (2) Applicable generally accepted auditing standards

(GAAS); (3) Audit or Opinion audit; (4) Compensated auditor; (5) Financial statements; (6) Generally accepted accounting principles (GAAP); (7) Generally accepted auditing standards (GAAS); (8) Independence or Independent; (9) Independent, licensed, certified public accountant; (10) Internal controls; (11) Other comprehensive basis of accounting; (12) Related party transactions; (13) Reportable conditions; (14) Substantive testing; (15) Supervisory committee; (16) Supervisory committee audit; and (17) Working papers. The NCUA Board also requested comment on whether any additional terms should be defined in the regulation.

Eight commenters believe no further terms should be defined while three commenters believe the final amendments should define additional terms. One commenter requests a definition of ''verifications.'' One commenter requests NCUA define ''summary of operations'' One commenter believes NCUA should define ''internal auditor'' and ''Standards for the Professional Practice of Internal Auditing.'' Thirteen commenters believe that the proposal adequately defined the terms listed. Three of these commenters state that the definitions are valuable to credit unions. Four commenters believed that the proposal does not adequately define the listed terms.

Generally, if several commenters suggested redefinitions along the same lines and the suggested language was technically correct, the final regulation reflects the revised language. Definitions for ''internal auditor'' and ''Standards for the Professional Practice of Internal Auditing'' were not added as neither of these terms are used anywhere in the regulation. A definition for ''verifications'' was not added since it is defined and discussed fully in the existing regulation, § 701.12(e). ''Summary of operations'' is simply a phrase which was used within the ''financial statements'' definition which is not critical to an understanding of the definition or the regulation; this phrase was dropped. One definition was added and that was the SAS No. 75 definition of ''specified elements, accounts or items of a financial statement.''

The definition of ''applicable GAAS'' and the use of that term was dropped throughout the regulation. In the proposed regulation, we had defined ''applicable GAAS'' as GAAS excluding the second general standard and the standards of reporting. In the final regulation, we dropped the term ''applicable GAAS'' and instead spelled out five specific standards, contained in paragraph (c)(2). The five standards were adopted with modifications from the AICPA's ten generally accepted auditing standards, again excluding the second general standard and the standards of reporting. The Board believes that the use of the term ''applicable GAAS'' may intimidate laymen; spelling out the specific standards intended should help eliminate any apprehension. The Board believes these standards are reasonable and attainable.

The proposal defined ''audit or opinion audit'' in part, as an examination of the financial statements performed by an independent, licensed, certified public accountant in accordance with generally accepted auditing standards. One commenter believes that this definition must be modified. This commenter states that an ''audit'' and an ''opinion audit'' are not the same thing, and not all credit unions need an opinion audit which is performed by an ''independent, licensed, certified public accountant.'' One commenter states that since the definition applies to the word ''audit'' alone it is unclear if this requirement applies everywhere in the regulation where the term is used. For example, this commenter states that ''Supervisory Committee Audit'' could mean an ''audit'' by a CPA, which the commenter believes is beyond the scope of what NCUA is requiring with this proposal. This commenter suggests restricting the definition to only ''opinion audits.'' One commenter states that there is an inconsistency between the definition of ''audit'' or ''opinion audit'' and the proposed supervisory committee audit in Section 701.12(c). This commenter states that the definition states an audit is to be performed by an independent, licensed, certified public accountant; whereas Section 701.12(c) provides other alternatives in the completion of an audit and specifically provides that someone other than a certified public accountant such as the supervisory committee may conduct audits.

Within the accounting profession and as represented in GAAS, ''audit'' is the term used for an ''opinion audit''. In fact, ''opinion audit'' is jargon for ''audit''; the terms are synonymous. However, since the use of the term ''audit'' in the regulation without an accompanying adjective such as ''opinion'' or ''supervisory committee'' was confusing to some of the commenters, we have eliminated the definition of ''audit,'' narrowed the definition to ''opinion audit'' and use only the term ''audit'' (when used as a noun) throughout the regulation preceded by descriptive terms, e.g., *opinion* audit, or *supervisory committee* audit. As to the alternatives set forth in § 701.12(c), these relate to the performance of a supervisory committee audit. The scope of an opinion audit exceeds that a supervisory committee audit. Thus, an opinion audit which complies with GAAS, would exceed the requirements of the regulation.

The proposal defined a ''compensated auditor'' as any accounting/auditing professional who is compensated for performing the supervisory committee audit and/or verification services. Thirteen commenters believe that the term ''compensated auditor'' should be revised so as to distinguish between the credit union's internal auditor and the credit union's contracted external auditor. These commenters believe the proposal could be interpreted so that a compensated auditor is defined as an accounting or auditing professional who is employed directly by the credit union. Two commenters believe that the term ''compensated auditor'' should not include someone who simply lends a hand to the supervisory committee in completing the audit. Two commenters believe that external auditors should be licensed professionals (such as CPAs) to ensure that audits are detailed and reflect the actual financial condition of the institution.

The Board found the comments in this area helpful and has amended the definitions in response to some of the suggestions. It is not the Board's intent to include credit union employees acting in the course of their employment (internal auditors) or someone who simply lends a hand (volunteer). Nor is the Board comfortable with restricting the performance of supervisory committee audits to licensed professionals. The definition has been changed to exclude employees and to exclude individuals who perform no more than one compensated supervisory committee audit per calendar year. The later provision was added to ease the burden for small credit unions who may benefit through the assistance of a volunteer, someone who simply lends a hand, e.g., the local bookkeeper who, while compensated, performs the supervisory committee audit (one per calendar year) for a minimal and reasonable remuneration.

The proposal defined generally accepted auditing standards (GAAS) in part as the standards approved and adopted by the American Institute of Certified Public Accountants which apply when ''independent, licensed certified public accountants'' audit financial statements. One commenter believes this definition will substantially increase the costs of audits

for smaller credit unions that do not use a CPA. One commenter believes that the definition implies that a CPA is bound by GAAS but non-CPAs are exempted from certain provisions and that this is unfair to the CPA. One commenter states that the definition does not identify which items of GAAS do not apply to the supervisory committee or its uncompensated auditor.

In the final regulation, the Board has eliminated the use of the term ''applicable GAAS'' and refers to GAAS only once in the final regulation—in paragraph (c)(4), in conjunction with expanded scope for compensated auditors. The term ''applicable GAAS'' appeared to intimidate many commenters. The Board has replaced this approach by listing five relevant standards in the body of the regulation. The standards were adopted with modifications from the AICPA's ten generally accepted auditing standards, again excluding the second general standard and the standards of reporting. Procedures and testing performed consistent with the five identified standards are required for credit union supervisory committees, whether they hire a compensated auditor or not. Scope of work within the guidelines of the regulation, and degree of substantive testing (nature, extent and timing), are set by the supervisory committee or its designated representative based on its assessment of inherent risk, after gaining an understanding of the internal control environment. This approach does not bind a supervisory committee or its designated representatives to those requirements of GAAS which are definitionally unattainable, e.g., certain GAAS provisions a non-CPA cannot meet by virtue of the fact that he is not a CPA.

There is no additional burden imposed in redefining the standard supervisory committees must meet in the performance of procedures and testing. By eliminating the term ''professional auditing procedures and standards'' which is non-specific, and replacing it with a listing of the five specific, relevant standards, the Board is issuing clearer standards. The amendment will not substantially increase burden on small credit unions because the regulation clearly does not require a CPA opinion audit, neither in *scope of work* nor *reporting burden.* There is no requirement for financial statements to accompany the report; no opinion is necessary; and negative assurance is not required. Since many of the commenters misunderstood certain provisions of the proposed regulation, their estimates of burden were based on a scope of work and reporting requirements substantially greater than what was actually proposed and/or intended. An additional burden exists only in the area of audit scope (not reporting) *when the work is performed by a compensated auditor.* While there is increased burden to some credit unions resulting from this requirement, the Board believes it is necessary and minimal.

The proposal defines ''independence and independent'' as ''without bias with respect to the credit union so as to maintain the impartiality necessary for the reliability of the compensated auditor's findings. Independence requires the exercise of fairness toward credit union management, members, creditors and others who may rely upon the independent, compensated auditor's report. Auditors must be independent in fact and in appearance.''

Eighteen commenters believe that this definition may pose problems for state leagues because some leagues are owned by credit unions for which the league provides audit services. These commenters request that the definition be clarified because they believe if the proposed definition of ''independence'' is strictly applied it could put league audit services out of business. They request that the preamble to the final amendments specifically state that league auditing programs are considered independent under the regulation. Seven commenters believe that a league audit is considerably cheaper than an audit by an accounting firm and if the state league was prohibited from doing the audit it would result in increased costs to credit unions. Some commenters also believe this definition should not be construed to mean that only CPAs could perform audits for credit unions. Several commenters recommend deleting the following sentence from the definition: ''Auditors must be independent in fact and in appearance.''

NCUA has revised the definition for ''independence'' to exclude the following: ''without bias with respect to the credit union'' and ''Auditors must be independent in fact and in appearance.'' Further, it is not the Board's intent to exclude league auditing services from performing supervisory committee audits or to require such services to use report terminology reserved by state laws specifically for CPAs. The Board is persuaded, however, that to be considered independent, league auditors must be *independently managed.* League auditors will not be considered independent in providing supervisory committee audits for a credit union if the credit union to be audited has an executive/employee on the affiliated league board who influences board decisions relative to the league auditing service. League auditors would be considered independent if the executive/employee on the affiliated league board recuses himself from all discussions, decisions, or actions directly or indirectly related to the league auditing service/department/function and/or meeting any requirements of this section. Additionally, the recusal must be documented in the written board minutes. Another alternative would be for reciprocity of league auditing services between leagues and credit unions subject to this restrictive interpretation. A third alternative would be for the league auditing service to periodically obtain a peer review from another league auditing service, similar to current practice for AICPA-affiliated, CPA firms in public practice. Such a peer review would provide a reasonably independent quality review of the league auditing service's compliance with required auditing standards in the performance, documentation, and reporting of auditing services provided to federally-insured credit unions. The written peer review report would be available to NCUA, upon request, in conjunction with the examination of a particular credit union's supervisory committee audit and verification.

The proposal defined ''internal controls'' in part as the process, established by the credit union's board of directors, officers and employees designed to provide reasonable assurance of reliable financial reporting and safeguarding of assets against unauthorized acquisition, use or disposition. Furthermore, this definition stated that a credit union's internal control structure consists of five components: control environment; risk assessment; control activities; information and communication; and monitoring. One commenter states that this definition could result in a decrease in testing of internal control structures.

The supervisory committee's responsibilities with regard to internal controls is clearly set forth in § 701.12(b)(2)(i) and (c)(2). The compensated auditor's further responsibility with regard to internal controls is set forth in § 701.12(c). The proposed and final regulation does not decrease the amount of testing of internal control structures than is required in the existing regulation, nor does it drastically expand required testing. The Board intends that the supervisory committee attain an understanding of the internal control structure; assess the level of control risk;

and based thereon, determine the nature, timing, and extent of substantive testing necessary to comply with the minimum supervisory audit scope. The materiality level the supervisory committee chooses to govern scope and testing must encompass reasonable tests of the internal control structure commensurate with the size and complexity of the credit union under audit. Choosing a materiality level which results in no reasonable testing of internal controls would not be acceptable. Expanding audit scope to achieve a complete audit of the credit union's system of internal controls (commenter terms this ''full compliance audit'') *is not intended.* The Board is simply seeking the extent of internal control testing which is normal in the audit of financial statements. The distinction would be clear to accounting/auditing professionals; it may be less so to supervisory committee member volunteers.

The proposal defined ''related party transactions'' as transactions among or between parties where one party controls or can significantly influence the management or operating policies of the other so as to prevent the other party from pursuing exclusively its own interests. The proposals provided the following examples of related parties: credit union members and their families, and credit union officials and their families. The proposal also stated that examples of ''related party transactions'' include: interest-free loans or loans at below market rates; sale of real estate significantly below appraised value; nonmonetary exchange of property; and making of loans lacking scheduled terms for repayment. Three commenters believe the definition of ''related party transactions'' should include examples of related parties similar to those used in the preamble rather than those provided in the proposed definition. Two commenters believe that the examples of related parties in the definition is vague and obscures the meaning of the term.

The definition of related parties has been changed to eliminate credit union members and their families and to add examples of related parties to include: executive management, board members, supervisory committee members, credit committee members, employees and their families.

The proposal defined ''supervisory committee audit'' in part as an examination of the credit union's financial statement in accordance with applicable GAAS, which is performed by the supervisory committee or its designated representative as required by the regulation. Furthermore, the last sentence of the definition stated that an opinion audit as defined by this regulation satisfies the definition of ''supervisory committee audit.'' One commenter states that the supervisory committee responsibilities need to be specifically defined, as well as any sanctions or penalties, if any, that may be assessed and how they will be determined. One commenter states that the last sentence of this proposed definition should be eliminated. One commenter states that this definition implies that a supervisory committee audit must be undertaken by a certified public accountant. This commenter suggests NCUA use ''supervisory committee review'' instead of ''supervisory committee audit'' to clarify this issue.

The Board changed the definition of ''supervisory committee audit'' to drop the ''applicable GAAS'' reference, consistent with the addition of paragraph (c)(2) detailing five specific standards which must be met in the conduct of the supervisory committee audit. We continue to include the last sentence in the definition but have revised it to indicate that an opinion audit is one of several ways to satisfy the requirements of the regulation. It is a misinterpretation of the proposed regulation to conclude that a supervisory committee audit must be undertaken by a certified public accountant. The Board continues to use the term ''supervisory committee audit'' because this is how the function is identified in the Federal Credit Union Act. The Board is satisfied that the final regulation clearly defines the supervisory committee responsibilities, short of providing a written audit program. Available sanctions and penalties are those that are normally available to NCUA in dealing with regulatory non-compliance as granted throughout the Federal Credit Union Act and administered through the NCUA's Regulations.

The proposal defined ''working papers'' in part as the principal record, in any form, of the work performed by the auditor and/or supervisory committee to support its findings and/or conclusions concerning significant matters. The definition provided the following examples of documents that meet this definition: the written record of procedures applied, tests performed, information obtained, and pertinent conclusions reached in the engagement, audit programs, analyses, memoranda, letters of confirmation and representation, abstracts of credit union documents, reviewer's notes, if retained, and schedules or commentaries prepared or obtained by the independent, compensated auditor. One commenter specifically supports this definition. Several commenters believe that although they agree with the ''working papers'' definition, they do not agree that all of the examples of working papers cited therein meet the definition. They believe that all of the auditors' memoranda, personal notes, and commentaries do not make up the principal record of the work performed. They suggest references to these items be eliminated from the list of examples provided in the definition of working papers. One commenter believes the definition is so extensive that it may discourage the compilation of notes and other internal memoranda, to the detriment of the credit union having a thorough audit.

The Board believes that, in the past, accounting/auditing professionals have afforded themselves broad license in determining what they will provide to NCUA staff in the way of working papers. This situation has resulted through a wide interpretation, by some compensated auditors, of what constitutes ''proprietary information.'' The Board is persuaded that such discretion needs to be limited. NCUA staff needs access to a complete set of working papers. The Board believes much of what compensated auditors have held back as ''proprietary'' is integral to NCUA staff in assessing if the audit meets regulatory requirements. Requiring full access to existing working papers should in no way discourage the compilation of notes and other internal memoranda, to the detriment of the credit union having a thorough audit. The standards requiring working paper documentation is not changed, lessened or strengthened by this final regulation which is simply seeking full disclosure to NCUA staff of existing working paper information. Photocopies are not required.

D. Expanded Audit Scope

The proposed amendments expanded the required audit scope when a supervisory committee employs the services of a compensated auditor. The Board proposed the changes to address practical enforcement problems in the existing regulation, some of which have arisen through the examination process as a matter of course and others of which have arisen in litigation and in negotiating settlements. Additionally the changes were intended to eliminate vagueness regarding the required audit scope as well as improving supervisory committee audits. The vagueness of audit scope has been the subject of complaints from both credit unions and examiners.

The Board proposed that the supervisory committee audit shall be made by the supervisory committee or its designated representative using applicable GAAS. Furthermore, the Board proposed that for the compensated auditor, audit testing of the following areas must satisfy applicable GAAS for expressing an opinion on the financial statements taken as a whole: internal controls, cash, loans and interest thereon, shares and dividends and/or interest thereon, related party transactions, and the detection and reporting of errors and irregularities with regard to each of these areas.

Three commenters specifically support the new audit scope. Two commenters believe the clarification eliminates any possible confusion regarding the overall requirements of the audit. One commenter recommends that this section be revised to state that the supervisory committee shall determine whether the established internal controls are sufficient to identify/detect material errors and fraud. The Board does not believe it is necessary to revise this section to include the suggested language because the responsibilities of the supervisory committee with regard to ''internal controls'' and ''error, carelessness, conflict of interest, self-dealing and fraud errors and irregularities'' are already set forth.

Seventeen commenters believe a compensated auditor should follow GAAS. Two of these commenters believe credit union auditors should be held to the same high standards as auditors in other industries. One of these commenters stated that GAAS is the acceptable standard for all audits. One of these commenters believes that a compensated auditor should be required to follow GAAS but it should not be required by regulation. One supporting commenter believes that this amendment will have numerous unintended consequences, one of which will result in requiring any audit performed by a CPA to be an opinion audit. This commenter also believes the proposal could harm small credit unions by having them seek less qualified individuals.

As addressed above, the Board does not wish to require an opinion audit for credit unions. To require compensated auditors to meet GAAS in scope of work, audit testing and reporting would be to require an opinion audit by a licensed, independent certified public accountant. The Board believes adopting the five specific standards set forth in the final regulation is preferable to the existing rule's reference to ''professional auditing procedures and standards''; the former is specific while still allowing for reasonable judgment, the later is too vague. And while the expanded audit scope may slightly increase costs to some credit unions, the Board believes this burden is reasonable and necessary in light of the substandard audits NCUA found in some credit unions.

Twenty commenters believe compensated auditors should not be required to follow GAAS. One of these commenters believes that it appears to have the practical effect of requiring the performance of an opinion audit, except the actual issuance of an opinion, whenever an outside auditor is used. Six of the commenters believe such a requirement will increase credit union costs. Three commenters believe this requirement will hurt small credit unions. One commenter believes that the proposed GAAS requirements could result in small credit unions employing CPAs to perform the audit and could discourage members from volunteering to serve on the supervisory committee. In the final regulation, a standard far short of GAAS is being required. Five specific standards governing performance of the work are set forth in the final regulation. Financial statements are not necessary, an opinion or attestation is not required, negative assurance is not sought, and GAAS reporting standards do not have to be met, paragraph (c)(4). Only compensated auditors are being held to GAAS-level *scope* and *testing* (not reporting), and then, only in selected risk areas. We continue to believe that the increased burden estimates were based on a misunderstanding of proposed regulatory requirements.

One commenter states requiring non-CPA auditors to meet CPA standards is tantamount to requiring CPA audits. Another commenter states that league auditors are not allowed by AICPA rules to use the terms GAAS and GAAP in their audit reports. Furthermore, the commenter states that if these terms are required it will mean that only CPAs could audit credit unions which would prohibit league audits as well as increase credit union costs. The proposed and final regulations do not require non-CPAs to use GAAS and GAAP references or language in supervisory committee audit reports. In the proposed regulation the definition of ''applicable GAAS'' excluded the ''standards of reporting.'' The final regulation continues to exclude these reporting standards. The relevant standards governing performance of work have been more specifically identified in the final regulation in paragraph (c)(2).

One commenter believes that NCUA should determine what additional procedures should be performed, if any, on a credit union by credit union basis, rather than requiring all compensated auditors to complete an expanded scope. Another commenter also states that NCUA should not require expanded scope for all credit unions. It is not practical for NCUA to determine what additional procedures should be performed, if any, on a credit union by credit union basis, thus this alternative of requiring the supervisory committee or its designated representative to attain an understanding of the internal control environment, assess control risk, and based thereon, determine the extent of substantive testing necessary to meet the requirements of this section. The guidelines NCUA primarily will use in assessing the adequacy of the expanded scope under paragraph (c)(4) will be the AICPA's guide, ''Audits of Credit Unions'', relevant chapters, subheading ''Audit Objectives and Procedures'' where discussions are provided on audit objectives, planning considerations, internal control structure, tests of controls, and substantive tests. The expanded scope in selected, identified areas for all credit unions that employ a compensated auditor should contribute to improved consistency and uniformity.

One commenter believes the proposed amendments impose different and higher standards for supervisory committee audits conducted by compensated auditors than those performed by supervisory committees or uncompensated auditors. Two commenters believe the proposed amendment is an attempt to permit non-CPAs to perform the work of CPAs when auditing credit unions. Both commenters believe that this poses an increased risk of substandard audits which will fail in detecting serious accounting deficiencies and internal control weaknesses. Another commenter believes a non-licensed accountant attempting to comply with the regulation may be violating state accountancy law by performing duties which can only be performed by a licensed CPA. Another commenter does not believe it is realistic or feasible to require volunteer supervisory committee members to comply with a complex body of standards that require significant education and training to understand.

While the Board appreciates the seemingly unfairness of imposing a different and higher standard for supervisory committee audits

conducted by compensated auditors than for those performed by supervisory committees or uncompensated auditors, the Board must be realistic in recognizing that imposing an expanded scope requirement for supervisory committee audits performed by layman would be to invite certain disappointment. NCUA will need to review supervisory committee audits for thoroughness and sufficiency, and recommend needed supplemental procedures and testing to enhance the effectiveness of the audit process. Furthermore, for those supervisory committees that continue to perform the audit and/or verification themselves, where the credit union's sophistication and complexity have grown beyond the capabilities of the resident supervisory committee and its staff, it will be incumbent upon NCUA to recognize the deficiencies in the audit which diminish the committee's usefulness in the oversight process assigned it under § 701.12. NCUA has significant flexibility under § 701.13 of NCUA's Regulations, through FIRREA, to call for the conduct of a second audit, one which will fulfill the intended objectives of this regulation. The requirement for a second audit would add burden since it must be performed by an independent public accountant.

E. Engagement Letter Requirement

The Board proposed to require credit unions which employ compensated auditors to memorialize the terms and conditions of the engagement in a comprehensive engagement letter, which constitutes an enforceable contract between the compensated auditor and the supervisory committee. The proposal also set forth the minimum requirements of an audit engagement to be addressed in such a letter. The Board made this proposal to further reduce the confusion for required scope components that are excluded from the audit engagement. Thirty-eight commenters support this proposal. Fourteen of these commenters believe the requirements for an engagement letter should adequately protect the interests of the supervisory committee. Five commenters believe the engagement letter will formalize the expectations of the supervisory committee. Four commenters believe that this proposal would eliminate any misunderstandings between the supervisory committee and the auditing firm. One commenter supports the requirement to provide an appendix to the engagement letter specifying the procedures to be performed.

Seven commenters believe it should be left to the discretion of the credit union to determine what specific details should be included in the engagement letter. Conversely, two commenters believe that NCUA should produce a form engagement letter in the final rule. In current practice, the engagement letter has been written primarily by the compensated auditor, for the compensated auditor. Many credit unions have signed the engagement letters thus drafted without a real knowledge or understanding of what specific details should be included. Through the engagement letter requirement, the Board hopes to help credit unions in its business dealings with the professional auditor. The regulation sets forth minimums; the credit union has full discretion to include other provisions.

The compensated auditor has the option to exclude from his scope of work any areas for which he is uncomfortable/unwilling to perform the expanded audit scope, if such exclusion is agreeable to his credit union client. He is obligated then only to caution the supervisory committee in the engagement letter that the supervisory committee will remain obligated to perform or have performed this required but excluded work. As concerns areas excluded from the audit engagement, simple, general statements, such as is demonstrated in the current AICPA Guide, Audits of Credit Unions, illustrative engagement letter, with the added caution required in the rule, § 701.12(d)(3)(i)(C), is the minimum NCUA is seeking. For example, ''The scope of this audit * * * does not include an evaluation of all areas that generally are of higher risk in the credit union industry, such as securities held or the collectibility of loans, the adequacy of collateral thereon, or the reasonableness of the allowance for loan losses,'' plus cautionary language required consistent with this section.

Five commenters stated that the requirement in the proposal that the engagement letter specify a date of delivery of the written audit report is unrealistic. They believe that the auditor can not complete the audit if the required information is not available. One commenter believes this requirement puts undue pressure on the auditor. One of these commenters stated that we should not require an exact delivery date but rather a ''target'' delivery date. The Board agrees with this commenter. Delivery date has been changed to ''target date of delivery.'' The intent is to provide the auditor with flexibility in dealing with unforeseen events while providing NCUA with a target date for receiving the report.

Nine commenters do not believe NCUA should require a formal engagement letter. One commenter believes that the requirement for an engagement letter will not adequately protect the interests of the supervisory committee. One commenter states this should not be a regulatory requirement since most credit unions already use an engagement letter. One commenter states that the use of an engagement letter is a management decision. One commenter believes the additional cost for this separate letter far outweighs the perceived benefit. Two commenters believe regulating the content of an engagement letter is unnecessary. One commenter states that the criteria and the matter to be included in the engagement letter as outlined by SAS 75 address questions concerning the conditions for engagement preference, the sufficiency of procedures, the nature, timing and extent of procedures and will address issues that may arise between the auditor and the supervisory committee.

The NCUA Board believes the engagement letter requirement will protect the credit union, will compel communication concerning the audit engagement, and will provide all parties with an enforceable contract and a documented record of accountability which hopefully will preclude NCUA from brokering disputes between the credit union and the compensated auditor. Credit unions are free to include any additional criteria, conditions, terms in the engagement letter beyond those required (such as those additionally outlined in SAS No. 75); again, the regulation is suggesting the minimum requirements. The final amendment reflects engagement letter requirements, generally as proposed, with the addition of target date of delivery, and working paper retention requirements for 3 years from the date of the audit report.

F. Requirement for a Written Report of Internal Control Exceptions or Reportable Conditions and a Written Report of Irregularities or Illegal Acts

The proposed amendments required written reports of any internal control exceptions or reportable conditions noted and of any irregularities or illegal acts noted. Eighteen commenters support the requirement to report on internal controls and possible illegalities. Ten commenters state that requiring these reports will not increase the cost of a supervisory audit. Two commenters, although supporting the requirement, believe it will increase credit union costs. Three commenters state that the information in the reports

is already available in some form of report. We agree the information is already available as a result of performing the supervisory committee audit, but current requirements do not mandate written communication.

Thirty-seven commenters oppose this requirement. Twenty-six commenters state that requiring these reports will increase the cost of supervisory committee audits. Five commenters wondered why the auditor cannot simply report any such findings in their normal report to the supervisory committee instead of creating two new reports. This option is agreeable to NCUA; we are simply seeking such information be ''reduced to writing.'' Three commenters believe that no report should be required if no internal control exceptions, reportable conditions or irregularities or illegal acts were noted. This is also agreeable to NCUA; we are not seeking negative assurance. One commenter states that auditors that find problems during the scope of their normal audit already comment on internal controls and fraud when appropriate in the audit report to the credit union. Not necessarily; CPAs are not required to communicate such matters in writing. One commenter states that one report should be able to handle both issues. The Board agrees and the final regulation reflects this.

Two commenters believe this requirement will hurt smaller credit unions since they usually have weaker controls due to small staffs. This requirement was not added to ''hurt smaller credit unions,'' but often these are the very credit unions where efforts are needed to bolster internal controls. One commenter states that the requirement to have the compensated auditor report on internal control and fraud may not be valid for all credit unions. This commenter believes that credit unions having an internal audit function should be exempted from this requirement to avoid duplication of efforts and costs. The internal audit function could be the means by which the supervisory committee chooses to comply with this section.

This was one of the most misunderstood proposed amendments to the regulation. NCUA is simply asserting that any instances of reportable conditions or errors and irregularities which are identified *in the normal course of a supervisory committee audit*, be *reduced to writing.* Currently, while such information must be reported, GAAS does not require this information to be in writing. Without written communication of these items, NCUA has limited assurance of gaining knowledge of the auditor's observations in these areas, unless the credit union provides notification voluntarily.

NCUA does not expect or require any negative assurance; no report is required if internal control exceptions, reportable conditions or irregularities or illegal acts were not noted. In many supervisory committee audit reports prepared by compensated auditors other than CPAs under existing guidelines, such internal control and fraud problems/weaknesses uncovered during the scope of their normal audit are already commented upon, when appropriate, in the audit report to the credit union. This practice continues to meet regulatory requirements under the final regulation.

NCUA has no preference whether the auditor prepares one report including this information, two reports or three; what matters is that the information is *reduced to writing.* NCUA does not expect supervisory committees to direct audit scope at discovering such problems. Nor is NCUA seeking a specific report on the control structure and any breaches of that structure or to specifically note the absence or presence of any irregular or illegal act; NCUA recognizes this would require a substantially different level of audit than heretofore has been required. The NCUA Board believes it is possible that those who argued ''burden to small credit unions'' in this reporting aspect misunderstood the intended reporting requirements in this instance, and mistakenly magnified cost estimates accordingly.

G. Clarification on Access to Original Working Papers

The proposal clarified that NCUA has unconditional access to a complete set of original working papers including all the existing documentation relative to the audit. Such access would be either at the offices of the credit union or at a mutually acceptable location. Thirty-four commenters provide varying support for the clarification. Sixteen commenters believe that unconditional NCUA access to original working papers is not overly burdensome and intrusive. Six commenters do not believe unconditional access to working papers will cause an increase in administrative and other expenses. One commenter believes that such access to original working papers will assist NCUA in its exams and that the clarification makes good business sense. Five commenters state that it is important to maintain the confidentiality of the working papers. NCUA appreciates the auditor's concerns about maintaining the confidentiality of working papers and will cooperate reasonably with auditors to achieve this end.

Two commenters believe this section should be clarified to provide that copies, certified copies or electronic formatted data are ''originals'' for the purpose of this section. Relevant to the most recent audit completed and awaiting NCUA review, the Board rejects the notion that ''copies, certified copies or electronic formatted data are ''originals'' for the purpose of this section.'' Subsequently, and for purposes of meeting the three year working papers retention expectation, accessible alternative electronic storage is acceptable. One commenter, although supporting the proposal, believes this proposal may increase credit union costs. NCUA does not believe this clarification to the existing regulation will increase the costs to credit unions. This requirement would simply be included in the engagement letter as a clarified condition of engagement.

Three commenters state that the location for viewing the working papers must be flexible because the credit union may be located some distance from the office of the auditor. Two commenters believe that the location for NCUA access should include the external auditor's place of business. The ''mutually agreeable location'' alternative does provide for the external auditor's place of business. One commenter recommends that working papers should be made available only at the auditor's place of business for the NCUA to copy or review. This the Board finds too restrictive and continues to prefer ''or at a mutually agreeable location.'' One commenter requests that the final regulation clarify that the working papers be available, either at the auditor's or credit union's office with adequate notice and under the auditor's supervision. The proposal stated that working paper access could be at the offices of the credit union or at a mutually agreeable location. A ''mutually agreeable location'' could be at the credit union, at the auditor's place of business, or other location agreeable to the auditor. NCUA staff will be instructed to be reasonable in their negotiation of ''mutually agreeable location.'' One commenter would also put in the regulation that such access would be at an agreed upon time and an agreed upon location. The Board believes this to be the normal business practice. This commenter also believes that notes could be made but not copies. Several other commenters state that copies of the working papers should not be permitted. The Board did not propose and will not incorporate in the final regulation any requirement for

NCUA to photocopy the working papers.

Twenty-seven commenters oppose the clarification on working papers. Twelve commenters stated that complete access to the original working papers is overly burdensome and intrusive. Such access exists under the current regulation. Eight commenters believe unconditional access to working papers will cause an increase in administrative and other expenses. This should not be the case since: such access exists under the current regulation and such access will be a condition of engagement. Several commenters believe that the working papers are the property of the compensated auditor and not the credit union unless the papers are prepared by the supervisory committee. NCUA recognizes that the working papers prepared by a compensated auditor are the property of the compensated auditor. Several commenters were concerned with an examiner copying the working papers and then having the examiner retire and compete with the auditor using the auditor's program. Examiners are prohibited from copying audit programs for their personal use.

One commenter believes that the supervisory committee should not be held accountable for making sure that an independent auditor makes his or her original working papers available to NCUA since that provision is already included in the engagement letter and, as a practical matter, there is not much the supervisory committee can do to enforce that provision beyond the confines of the engagement letter. NCUA disagrees; the supervisory committee can enforce its audit contract. Several commenters believe that original working papers are the property of the auditor. NCUA acknowledges this. One of these commenters states that while the auditor can and must agree to make those papers available, NCUA has no role in enforcing that requirement against an independent auditor over whom it has no regulatory powers. NCUA acknowledges that enforcement lies with the supervisory committee. One commenter states that the proposal puts the credit union in a ''no-win'' situation. If the auditor fails to cooperate with the supervisory committee by not making the papers available, rejection of the audit is a possibility, which may result in additional expenses for a new audit or the NCUA may seek formal administration sanctions against the supervisory committee. This is true, but presently, without this provision, NCUA is ''brokering disputes'' between compensated auditors and supervisory committees. An enforceable contract should remove both NCUA and supervisory committees from the middle. With an enforceable contract, there will be a clearly defined line of responsibility and thus, a business pressure, if not the possibility of litigative pressure, for the honoring of contract terms. If a compensated auditor does not wish for NCUA to review his working papers, he should not agree to be engaged by a credit union.

One commenter believes NCUA should specify a working paper retention policy to clarify how long the working papers must be available for review. The Board agrees that an auditor should not have to retain his/her working papers indefinitely. Therefore, the Board has amended the regulation to require retention of working papers by compensated auditors for a minimum of three years from the date of the written audit report. The audit working papers for the most recent audit would need to be retained in paper form; subsequently, alternative, accessible storage would be acceptable.

H. Enforcement Mechanism

The Board proposed an enforcement mechanism to ensure compliance with this regulation by authorizing the regional director, as a first step toward enforcement, to reject as deficient the supervisory committee audit and the reports thereof. Two commenters support this proposal. One commenter encourages the NCUA Board to ensure that all regional offices use the same criteria for determining whether or not to accept a supervisory committee audit (whether or not performed by a compensated auditor). Two commenters oppose the proposal. One of these commenters believes that only state credit union supervisory agencies should initiate administrative sanctions against the supervisory committee of a state chartered credit union. Furthermore, this commenter notes that the proposed amendments bestow a great deal of discretionary authority upon regional directors and suggests the Board instruct regional directors not to reject audits which are flawed by minor technicalities.

In the case of a federally-insured state chartered credit union, the Board believes it is appropriate for the state regulator to first attempt to resolve any problems concerning the supervisory committee audit. The Regional Director will take action after the state regulator has had a reasonable opportunity to reach a satisfactory result. The Board will instruct its regional offices on the proper criteria in determining whether to accept or reject a supervisory committee audit to minimize differences among the regions and provide more consistency. NCUA will not be rejecting supervisory committee audits for minor technicalities.

I. Effective Date

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 requires the federal regulators of banks and savings associations to make all regulations that impose new requirements take effect on the first date of the calendar quarter following publication of the rule unless good reason exists for some other effective date. Although NCUA is not formally subject to this requirement, Letter to Credit Unions #158 stated that the requirements would be beneficial to credit unions and that NCUA planned to implement it whenever practicable. NCUA believes that delaying the effective date to December 31, 1996 is necessary so that credit unions and individuals conducting supervisory committee audits have sufficient time to understand the regulation and determine what type of audit will best serve their needs. Therefore, the regulation will be effective for audits conducted for, and covering, the audit period ending on December 31, 1996, and thereafter.

J. Request for Comment on Whether Credit Unions Should Have an Ongoing Internal Audit Function

The Board requested comment on whether it should mandate an internal audit function and, if so, whether such a requirement should be imposed on all or only some credit unions, and on what basis. Seventeen commenters support mandating an internal audit function. Ten commenters believe an audit function should be required based on some combination of asset size and complexity of operations. Two commenters believe it should be required for credit unions with assets in excess of $100 million. Another commenter believes it should be required for credit unions with assets over $150 million. Another commenter believes asset size should be the basis for requiring an internal audit function. One commenter believes the audit function should be based on complexity of operations and not asset size.

Fifty-three commenters oppose requiring a credit union to have an ongoing internal audit function. Thirty-three commenters believe the decision to have an internal audit function should be made by credit union management. Four commenters believe that many credit unions can not afford an internal audit function. Two

commenters believe the internal audit function is costly and that the internal auditor may not adequately scrutinize operations. Several commenters believe NCUA should not require but instead encourage large and complex credit unions to have an internal audit function.

Three commenters believe that both compensated auditors and internal auditors should be hired, report to and receive instructions from the supervisory committee. They believe any other line of reporting compromises the integrity of the communication. Sixteen commenters believe it is not always feasible or desirable for the auditor to report directly to the supervisory committee, especially if the credit union is relatively large. Most of these commenters believe that each credit union should decide to whom the auditor reports.

The Board is not requiring an internal audit function at this time because it believes that the costs of mandating such a function for all credit unions outweighs the perceived benefit. The Board, however, continues to encourage credit unions to have an ongoing internal audit function if management believes it would be helpful as well as economically prudent. The Board also believes it is important to minimize possible conflicts of interest when determining to whom the internal auditor reports. Management should carefully consider whether it is feasible for their credit union to have the compensated or internal auditor report to the supervisory committee.

K. Relevance of SAS No. 75 to CPAs and Its Impact on Supervisory Committee Audits

Effective May 1, 1996, the AICPA adopted SAS No. 75 which provides in pertinent part:

b. The accountant and the specified users agree upon the procedures performed or to be performed by the accountant.

c. The *specified users take responsibility for the sufficiency of the agreed-upon procedures* for their purposes. (emphasis added)

In essence, SAS No. 75 requires the CPA to identify the ''specified users'' of a ''report on agreed-upon procedures'' and, in advance of such an engagement, to obtain an acknowledgment from all identified specified users that the procedures the auditor will perform are sufficient to satisfy the ''specified user's'' needs. There is no doubt that a credit union's supervisory committee and its board of directors are ''specified users'' because they will rely on the auditor's report. However, some may contend that, in addition, NCUA itself is a ''specified user'' of each credit union's supervisory committee audit report. This would put NCUA in the position of having to agree with the CPA and each credit union as to the agreed-upon procedures the CPA will use to ensure that each credit union's audit satisfies the requirements of § 701.12.

To expect NCUA to acknowledge the sufficiency of a set of procedures in meeting this part prior to the credit union's engagement of a CPA is both infeasible and would shift the responsibility for the supervisory audit from the credit union's supervisory committee to NCUA. The supervisory committee or its designated representative, not NCUA, is uniquely able to ''attain an understanding of the internal control environment, assess control risk, and based on the control risk, determine the substantive testing (nature, extent, and timing) necessary'' to comply with this section.

Many credit union supervisory committees hire a compensated auditor because they do not have the expertise necessary to perform the supervisory committee audit. Supervisory committees consisting primarily of volunteers cannot be expected to acknowledge the sufficiency of a set of agreed-upon procedures developed by accounting professionals. In such cases, the supervisory committee would naturally rely upon the assistance of a CPA to attain an understanding of the internal control environment, assess control risk, and based on the control risk, determine the substantive testing that is necessary.

Since 1985, NCUA's objective has been to place with the credit union and its supervisory committee the responsibility for sufficiency of audit procedures and testing. This approach was enunciated in the preamble to the 1985 rule, as follows:

The supervisory committee must carry out its duties in a manner responsive to each credit union's circumstances, i.e., the supervisory committee must use good judgment in determining the scope, the frequency, and the detail of the committee's activities. (Deregulation efforts recognized that) * * * a credit union's audits and reviews must reflect each credit union's business activities and financial and operating condition. The committee's work requires judgment of each credit union's needs based on an analysis of each institution's strengths and weaknesses * * * *Since the committee is responsible for the audit, it should determine the scope of the work to be performed. The scope of the work should be varied based on the nature of risk and exposure for each transaction or account being audited within each federal credit union.* [50 CFR 8710, March 5, 1985] (emphasis added).

NCUA's approach is consistent with the approach of the auditing profession today. In fact, SAS No. 75 is premised upon this same line of reasoning, shifting this burden away from the independent accountant to the specified user.

The issue created by AICPA's adoption of SAS No. 75 exists under both the current, and this revised supervisory committee audit regulation. Some compensated auditors suggest that SAS No. 75 limits them to performing only opinion audits for credit unions. To the extent that this claim is true, both the cause and the remedy for this limitation resides with the accounting profession.

The NCUA Board continues to welcome the CPA practitioner in the performance of supervisory committee audits as one of several favorable options for credit union supervisory committees. It is the NCUA Board's intent to allow credit unions a full range of options in whom they may contract with to have their audit work performed. NCUA will continue to work with the AICPA toward a practicable solution to this question to enable CPA practitioners to perform non-opinion, supervisory committee audits.

L. Comments Received on Regulatory Procedures

Regulatory Flexibility Act

The NCUA Board has certified that small credit unions (less than $1 million in assets) will not see a significant impact because of this proposal. Fourteen commenters believe that NCUA's assessment of the monetary costs of these changes is wrong. Two of these commenters believe it will effect credit unions under $50 million in assets by doubling the cost of the supervisory committee audit. Another commenter states it will substantially increase the cost for small credit unions. NCUA believes these burden estimates are based on a misunderstanding of the proposed requirements as discussed above, especially in the areas of scope of work and reporting.

In the final analysis, a cost of doing business as a credit union or any other financial institution is the conduct of an audit to ensure member confidence. The audit must be performed by persons with audit skills commensurate with the complexities of the credit union. For credit unions under $1 million who are already hiring a compensated auditor to

perform the supervisory committee audit, NCUA believes the engagement letter requirement, the expanded scope requirement, and ''reducing to writing'' identified reportable conditions/errors or irregularities may minimally increase costs. It is a normal business practice for compensated auditors to obligate audit clients to sign engagement letters and many of the affected credit unions are already doing so. Merely ''reducing to writing'' identified and known reportable conditions and/or errors and irregularities cannot be significantly burdensome. The expanded scope requirements then require examination.

Cost can be controlled or reduced by the credit union establishing or strengthening its system of sound internal controls which serve to contain control risk. Favorable control risk can mean the reduced necessity for extensive substantive testing, thus, lower audit costs. We estimate that approximately 64% of the credit unions under $1 million have supervisory committee audits which are performed by the supervisory committee itself (not affected); receive opinion audits (already meet expanded scope); or engage outside auditors who do not meet the definition of ''compensated auditor'' (not affected). Thus, few, if any, of these estimated credit unions will be significantly affected by the expanded scope requirements of this section.

Paperwork Reduction Act

In the proposal the NCUA Board estimated that for most credit unions the additional paperwork will require only one to three hours a year of additional time. One commenter asks if NCUA has determined the extra time needed for auditors to complete the additional reports required by the proposed regulation. Another commenter believes the paperwork requirements are much higher than stated in the proposal.

The additional paperwork burden to the credit union is *only relevant to credit unions hiring compensated auditors* and lies primarily in the engagement letter requirement and in ''reducing to writing'' reportable conditions and/or errors and irregularities, if any, NCUA did not include paperwork burden as to the compensated auditor, simply additional paperwork burden as to the credit union. NCUA continues to believe the paperwork burden to credit unions is in line with original estimates.

M. Miscellaneous

One commenter requested that the final rule or its preamble explicitly state that this rule does not apply to corporate credit unions. Section 701.12 does not apply to corporate credit unions. One commenter believes that the proposal unfairly singles out those credit unions that are attempting to upgrade their operation by hiring an independent auditor to do the annual supervisory committee audit. NCUA encourages supervisory committes to avail themselves of the services of compensated auditors when it is advisable and feasible to do so; this regulation is in no way designed to discourage credit unions from doing so. The Board is persuaded in all but the exceptional case, supervisory committees will choose the auditor alternative which is best for its credit union under the circumstances. Failing this, the Board is confident that the annual examination process will identify those credit unions in which evoking the FIRREA provisions of § 701.13 will become necessary.

The Board is not issuing any changes to the current regulation regarding the independence and verification of members' accounts but they will be redesignated as § 701.12(g) and (h), respectively. The Board is adopting in final the one proposed change to § 701.13 to redesignate the current § 701.12(e) as § 701.12(h).

N. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). As noted above, NCUA determined in the proposed rule that there was no significant economic impact on small credit unions. Comments received are discussed above. Accordingly, the NCUA Board determines and certifies that this final amendment does not have a significant economic impact on a substantial number of small credit unions and that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

Comments received on paperwork collection requirements are discussed above. The information collection requirements in the final rule have been submitted to the Office of Management and Budget. The control number assigned for this rule is 3133–0059, approved for use through April 30, 1997.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The final amendments will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of rights and responsibilities among the various levels of government.

List of Subjects in 12 CFR Part 701

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on July 24, 1996.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701 and 707

Organization and Operations of Federal Credit Unions; Truth in Savings

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The NCUA Board is implementing two provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. First, the Board is raising the threshold of credit union board of directors' approval of loans to officials from $10,000 to $20,000. Second, the Board is permanently exempting small, nonautomated credit unions from Truth in Savings compliance.

DATES: This final rule is effective December 27, 1996.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: Sparky Conrey, Staff Attorney, Office of General Counsel, telephone (703) 518–6540, and Jodee Wuerker, Compliance Officer, Office of Examination and Insurance, telephone (703) 518–6360.

SUPPLEMENTARY INFORMATION:

(1) Loans to Officials

On September 30, 1996, the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (the ''Act'') was enacted. Section 2306 of the Act amended sections 107(5)(A) (iv) and (v) of the Federal Credit Union Act, by raising the threshold of loans to officials that require credit union board of director approval from $10,000 to $20,000. 12 U.S.C. 1757(5)(A) (iv) and (v). These statutory provisions are currently implemented in section 701.21(d) (1) and (4) of NCUA's Rules and Regulations. 12 CFR 701.21(d) (1) and (4). The $10,000 amount is changed to $20,000 in these two sections. All other portions of the rules regarding loans to officials remain the same.

(2) Truth in Savings

Background

NCUA has previously extended the compliance date three times of part 707, which implements the Truth in Savings Act (TISA), for certain small, nonautomated credit unions. Each time, the NCUA Board took into consideration the limited resources of the exempted credit unions. The last extension was due to expire on January 1, 1997. 60 FR 57173 (November 14, 1995).

Section 2604(c) of the Act exempts from TISA requirements ''any nonautomated credit union that was not required to comply with the [TISA] as of the date of enactment of the [Act], pursuant to the determination of the [NCUA] Board.'' The NCUA Board has previously exempted nonautomated and insufficiently automated credit unions with an asset size of $2 million or less as reported to, or determined by, NCUA. An exemption had been supported by NCUA, the Department of the Treasury, and credit union trade associations in Congressional hearings and other legislative action, citing the hardships that would befall the small, nonautomated credit unions if TISA compliance became mandatory. These hardships potentially include: increased mergers of the affected credit unions into larger credit unions; increased voluntary liquidations; loss of volunteer support; allocation of credit union resources from member services to compliance; the expense, complications, and logistics of automating in order to comply; and loss of credit union services to members. Subsequently, Congress provided a TISA exemption for small, nonautomated credit unions.

The NCUA Board is concerned with the continued viability of small credit unions and the provision of continued financial services to their members. Ten years ago, credit unions under $2 million in size made up about two-thirds (10,564) of all federally insured credit unions. Today, such credit unions number only 3,401, about thirty percent of federally insured credit unions. In addition, the assets of today's 3,401 smallest credit unions are .9 percent of total assets in all credit unions, while credit unions of $2 million or less accounted for 7.7 percent of total assets ten years ago. The average credit union today has $28 million in assets, compared to $5 million ten years ago.

Because the Act recognizes the difficulty that small credit unions face in complying with the many requirements of the TISA, especially the calculation requirements, statutory relief is provided. It is important to note that this relief is available to a very small segment of credit unions. Almost four-fifths of credit unions with $2 million or less in assets are automated or have in-house data processing. NCUA has determined that there are about 704 credit unions under $2 million in assets that report having manual recordkeeping systems. Analogously, NCUA has also determined that there are about 607 credit unions under $2 million in assets that have no compensated employees. (These numbers do not include the approximately 645 non-federally insured credit unions that do not submit 5300 reports.) The actual number of credit unions exempt from TISA and part 707 is estimated by NCUA staff to be fewer than 1,000. Although the statutory exemption is permanent in nature, NCUA encourages exempted credit unions to continue to comply with the spirit and intent of TISA by providing full and fair account disclosures to members. Even with the extension, many small, nonautomated credit union activities comply with the purposes of TISA: to enable credit union members and potential members to make informed decisions about credit union accounts and to make meaningful comparisons with accounts at other financial institutions.

Definition of Nonautomated

The NCUA Board has decided to implement the Act's exemption for nonautomated credit unions by amending the coverage provisions of paragraph 707.1(c) and by adding a new Comment 707.1(c)–3 to Appendix C, Official Staff Interpretations. No application is necessary in order to obtain the exemption. However, as required by the Act, NCUA does determine a credit union's legibility for the exemption. Credit unions may contact the appropriate Regional Office to verify their use of the exemption.

By the term ''nonautomated status'' NCUA means those credit unions without adequate and sufficient in-house or vendor-provided computer or data processing capacity and capability to establish, operate and maintain a share and loan software program able to timely and accurately process all member transactions on all member accounts at the credit union. Thus, some exempted credit unions do have some computer capacity, such as a word processor or a computer with insufficient memory and power capabilities to operate a complete, up-to-date share and loan software program. Since these credit unions are not sufficiently automated for Truth in Savings purposes, it is the determination of the NCUA Board that such credit unions are entitled to the Act's exemption. NCUA generally has used the year-end NCUA Form 5300 report to determine the requisite nonautomation status and asset size for those credit unions filing Form 5300 reports that have been eligible for the previous TISA compliance date extensions. Credit unions which do not file Form 5300 reports are currently permitted to prove nonautomation

status and asset size by other means, such as verified self-certifications, certifications by appropriate state supervisory authorities, and other equivalent forms of proof. In the future, NCUA will use a combination of these methods to determine eligibility for the TISA exemption.

Operation of Exemption

The Act authorizes the NCUA Board to determine the extent and operation of the TISA exemption. All credit unions that were exempt from TISA regulation as a result of the prior NCUA compliance date extensions as of September 30, 1996, are exempt. These are credit unions with $2 million or less in assets, after subtracting any nonmember deposits, that are nonautomated as determined by the NCUA Board. If any of these credit unions grow to have more than $2 million in assets as of December 31 of any year, the NCUA Board will require such credit unions to comply with TISA and part 707 on January 1 one year after the December 31st (in other words, the credit union will have at least one year to prepare for compliance). Similarly, if a credit union becomes sufficiently automated to operate a complete share and loan system, such credit union will be entitled to the same compliance phase-in period. For example, if a credit union grows to over $2 million in assets on December 31, 1997 (or if it becomes sufficiently automated on December 31, 1997), it must begin compliance with TISA and part 707 on January 1, 1999. The NCUA Board believes that a previously exempt small credit union will need time to draft account disclosures, install TISA compliance software into its share and loan system, test its share and loan system, and make other decisions regarding its automation. By granting at least one full year before the previously exempt credit union must comply with TISA, the Board believes that it is allowing sufficient time for such a credit union to ease into TISA compliance. Also, if a new credit union is chartered with less than $2 million in assets, it will be eligible for the exemption until it no longer meets exemption eligibility criteria.

(3) Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). This rule will not have a significant economic impact on a substantial number of small credit unions and therefore a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the amendments do not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget (OMB). 60 FR 44978 (August 29, 1995).

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. This regulation makes no significant changes with respect to state credit unions since a temporary exemption is being made permanent. Therefore the rule will not materially affect state interests.

Administrative Procedure Act

The amendments and interpretation made to this part are not subject to the notice and comment provisions of the Administrative Procedure Act (APA), 5 U.S.C. 551 et seq. The amendments and interpretation implement new effective statutory requirements. In addition, no major changes are contemplated, or made, by this action since a temporary exemption is merely being made permanent. Therefore, the NCUA Board has determined that, in this case, the APA notice and comment procedures for these amendments and interpretation are impracticable, unnecessary, and contrary to the public interest. 5 U.S.C. 553(b)(3)(B).

List of Subjects

12 CFR Part 701

Credit, Credit unions, Reporting and recordkeeping requirements.

12 CFR Part 707

Advertising, Credit unions, Consumer protection, Interest, Interest rates, Truth in savings.

By the National Credit Union Administration Board on December 19, 1996.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 705, 747 and 790

Changes in Office Description and References

AGENCY: National Credit Union Administration (''NCUA'').

ACTION: Final rule.

SUMMARY: Last year, the NCUA Board established the Office of Chief Financial Officer, transferring to it the functions of the Office of the Controller and some of the responsibilities of the Office of Examination and Insurance. The description of and references to the Office of the Controller are deleted, and a description of and references to the Office of Chief Financial Officer are added. The description of the Office of Examination and Insurance is updated to reflect redistribution of duties. Two references in other parts of the Regulations are also updated. These changes update the Regulations to reflect the current structure and responsibilities of various agency offices and make technical corrections to references within the regulations.

EFFECTIVE DATE: August 30, 1996.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

FOR FURTHER INFORMATION CONTACT: Hattie Ulan, Special Counsel to the General Counsel, at the above address or 703–518–6540.

SUPPLEMENTARY INFORMATION: Part 790 of the NCUA Regulations sets forth NCUA organization, including descriptions of duties of all agency components. On July 25, 1995, the NCUA Board established the Office of Chief Financial Officer, transferring to it the functions of the Office of the Controller and some of responsibilities of the Office of Examination of Insurance. This document deletes the description of the Office of the Controller, and replaces it with a new description of the Office of Chief Financial Officer. It also makes changes to the description of the Office of Examination and Insurance to reflect current duties. Two additional technical changes are made. First, in Section 705.3, the reference to § 701.32(d)(1) is changed to § 701.34(a)(1) to reflect a recent change to Part 701. Second, the reference to 12 CFR part 4 in § 747.25(b) is corrected to read 12 CFR § 792.5(b). Section 747.25 was recently amended with the incorrect reference.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). The types of changes made by this rule have no economic impact on credit unions. These are merely housekeeping changes. Therefore, the NCUA Board has determined and certifies that, under the authority granted in 5 U.S.C. 605(b), this final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

This final rule does not change any paperwork requirements.

Executive Order

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. Since these are housekeeping changes only, there is no effect on state interests.

List of Subjects in 12 CFR Parts 705, 747 and 790

Credit unions.

By the National Credit Union Administration on August 8, 1996.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 747

Uniform Rules of Practice and Procedure

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is amending its regulatory provisions implementing the Uniform Rules of Practice and Procedure (Uniform Rules). The final rule is intended to clarify certain provisions and to increase the efficiency and fairness of administrative hearings.

EFFECTIVE DATE: June 5, 1996.

FOR FURTHER INFORMATION CONTACT: Steven W. Widerman, Trial Attorney, Office of General Counsel, 703/518–6557, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314.

SUPPLEMENTARY INFORMATION:

I. Background

Section 916 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. 101–73, 103 Stat. 183 (1989), required the NCUA, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors of the Federal Reserve System (Board) (agencies) to develop uniform rules and procedures for administrative hearings. The agencies each adopted final Uniform Rules in August 1991.[1] Based on their experience in using the rules since then, the agencies have identified sections of the Uniform Rules that should be modified. Accordingly, the agencies proposed amendments to the Uniform Rules on June 23, 1995 (60 FR 32882).[2]

The NCUA received four comments on the proposal. All commenters generally supported the proposal, but each suggested improvements or further revisions.

The final rule implements the proposal with certain changes, including revisions responsive to some of the concerns expressed by the commenters. The following section-by-section analysis summarizes the final rule and highlights the changes from the proposal that the NCUA made in response to the commenters' suggestions.

The OCC, OTS, FDIC and Board have published separate final rules, effective June 5, 1996, that are substantively identical to the NCUA's final rule (61 FR 20330 *et seq.*), except as noted below in regard to §§ 747.1 and 747.9.

II. Section-by-Section Summary and Discussion of Amendments to the Uniform Rules

Section 747.1 Scope

The proposal added a statutory provision to the list of civil money penalty provisions to which the Uniform Rules apply. The added provision was enacted by section 125 of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI), Pub. L. 103–325, 108 Stat. 2160, which amended section 102 the Flood Disaster Protection Act of 1973 (FDPA) (42 U.S.C. 4012a). Section 102 now gives each ''Federal entity for lending regulation'' authority to assess civil money penalties against a regulated lending institution if the institution has a pattern or practice of committing violations under the FDPA or the notice requirements of the National Flood Insurance Act of 1968 (NFIA) (42 U.S.C. 4104a). Under the FDPA, the term ''Federal entity for lending regulation'' includes the agencies and the Farm Credit Administration.

CDRI section 525 also gave the agencies authority to require a regulated lending institution to take remedial actions that are necessary to ensure that the institution complies with the requirements of the national flood insurance program if: (1) The institution has engaged in a pattern and practice of noncompliance with regulations issued pursuant to the FDPA and NFIA; and (2) has not demonstrated measurable improvement in compliance despite the assessment of civil money penalties. The final rule adds a new paragraph to the scope section that reflects this additional authority.[3]

The NCUA received no comments on this section, which is adopted as proposed.

Section 747.6 Appearance and Practice in Adjudicatory Proceedings

The proposal permitted the administrative law judge (ALJ) to require counsel who withdraws from representing a party to accept service of papers for that party until either: (1) A new counsel has filed a notice of appearance; or (2) the party indicates that he or she will proceed on a *pro se* basis.

The NCUA received one comment on this section. The commenter suggested that the proposal did not adequately address certain situations: for example, when counsel withdraws because of a lack of payment of legal fees that is caused by an agency asset freeze, or withdraws because the client discharged him or her. The commenter's implication is that it is unfair to require counsel to continue to accept service in these situations. Moreover, the commenter expressed concern that the administrative proceeding may become involved in a dispute between the client and counsel when the ALJ requires counsel to continue to accept service after a client discharges counsel. The commenter suggested that the rule should require that service be given to both the unreplaced counsel and the party.

The proposal was intended to ensure that a lawyer is always available to receive service in order to prevent a party from halting the administrative proceedings simply by evading service. The regulatory text is clear, however, that the ALJ has the discretion whether to require former counsel to continue to accept service. Fairness to counsel is among the factors the ALJ would consider in exercising this discretion, and the NCUA therefore believes that the provision as proposed is sufficiently flexible to accommodate the concerns raised by the commenter.

The final rule changes the proposal's reference from ''service of process'' to ''service'' to clarify that this section applies to all papers that the party is entitled to receive. This section is otherwise adopted as proposed.

Section 747.8 Conflicts of Interest

The proposal sought to improve in two ways the provisions governing the conflicts of interest that may arise when

[1] The agencies issued a joint notice of proposed rulemaking on June 17, 1991 (56 FR 27790). The agencies issued their final rules on the following dates: NCUA on August 8, 1991 (56 FR 37767); OCC on August 9, 1991 (56 FR 38024); Board on August 9, 1991 (56 FR 38052); FDIC on August 9, 1991 (56 FR 37975); and OTS on August 12, 1991 (56 FR 38317).

[2] On December 30, 1994, NCUA proposed an amendment to the provision of the Uniforms Rules which restricts ex parte communications, § 747.9 (59 FR 67655). The other agencies each issued a similar notice of proposed rulemaking in November and December 1994. The amendment makes clear that the scope of § 747.9 conforms to that of the Administrative Procedure Act. NCUA received two comments on this proposal, both of which are addressed below. This final rule implements the amendment to § 747.9.

[3] Another provision of the CDRI, section 406, amended the Bank Secrecy Act (BSA) (31 U.S.C. 5321) to require the Secretary of the Treasury to delegate authority to the Federal banking agencies, as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), to impose civil money penalties for BSA violations. The definition of Federal banking agencies includes the other agencies, but does not include NCUA. Therefore, while each of the other agencies has inserted this provision in its final rule, NCUA has not.

counsel represents multiple persons connected with a proceeding.

First, the proposal sought to protect the interests of individuals and financial institutions by expanding the circumstances under which counsel must certify that he or she has obtained a waiver from each non-party of any potential conflict of interest. The former rule required counsel to obtain waivers only from non-party institutions ''to which notice of the proceedings must be given.'' The proposal required counsel to obtain waivers from all parties and non-parties that counsel represents on a matter relevant to an issue in the proceeding. It thus ensured that all appropriate party and non-party individuals and institutions are informed of potential conflicts.

Second, the proposal simplified this provision by eliminating the requirement for counsel to certify that each client has asserted that there are no conflicts of interest. The NCUA Board believes that the former provision was superfluous because the responsibility for identifying potential conflicts resides with counsel.

The NCUA received one comment on this section. The commenter noted that the proposal may inhibit multiple representation that otherwise complies with applicable ethics rules. The commenter suggested that the proposal could inappropriately tilt the proceeding in favor of the agencies.

The provision does not limit the right of any party to representation by counsel of the party's choice. Rather, it ensures that all interested persons are informed of potential conflicts so that they may avoid the conflict if they choose. In the NCUA's view, it is reasonable to establish a baseline standard requiring the affirmative waiver of conflicts by all affected persons or entities in order to ensure the integrity of the administrative adjudication process. State rules of professional responsibility that impose more stringent ethical standards are unaffected by this requirement.

In addition, the NCUA is unpersuaded by the argument that the conflicts provision grants the agencies significant advantage in a proceeding. Persons and entities may be well and vigorously represented even if they are not all represented by the same counsel.

Therefore, the NCUA adopts this section as proposed.

Section 747.9 Ex parte Communications

The proposal sought to clarify that the restriction on ex parte communications parallels the requirements of the Administrative Procedure Act (APA). The current § 747.9(b) prohibits ex parte communications between a party, the party's counsel, or another interested person, and the NCUA Board or other decisional employee regarding the merits of an adjudicatory proceeding.

The agencies' intention when adopting the Uniform Rules in 1991 was that § 747.9 conform to, but not exceed, the scope of the APA provisions restricting ex parte communications. The APA prohibits ex parte communications between agency decisionmakers and ''interested persons outside the agency'' regarding the merits of an adjudicatory proceeding. 5 U.S.C. § 557(d). It also prohibits enforcement staff within the agency from participating or advising in the decision, recommended decision, or agency review of an adjudicatory matter except as witness or counsel. 5 U.S.C. § 554(d). The APA does not prohibit agency enforcement staff from seeking approval to amend a notice of, or to settle or terminate, a proceeding.

The current § 747.9(b) could in practice be misinterpreted to expand the prohibition on ex parte communications beyond the scope of the APA to prohibit communications between enforcement staff and the NCUA Board regarding approval to amend or to terminate existing enforcement actions. To insure against such an unintended result, the proposed amendment clarifies that the section is intended to conform to the provisions of the APA by limiting the prohibition on ex parte communications to communications to or from ''interested persons outside the agency,'' 5 U.S.C. 557(d), and by incorporating explicitly the APA's separation of functions provisions, 5 U.S.C. 554(d). This approach is consistent with the most recent Model Adjudication Rules prepared by the Administrative Conference of the United States (ACUS). ACUS, *Model Adjudication Rules* (December 1993).

The NCUA received two comments on this section. One commenter supported the proposal provided that it is limited to intra-agency communications concerning amending a notice of charges or settling or terminating a proceeding. The other commenter claimed that ''NCUA has not stated any compelling need for [the amendment], and we view the proposed rule as inconsistent with the fundamental principles of fairness built into our legal system.'' This commenter fails to recognize that the proposed amendment allows ex parte communications with the NCUA Board only on nonadjudicatory matters, such as when NCUA enforcement staff seeks NCUA Board approval to amend a notice of charges or to settle or terminate an existing enforcement proceeding. Other parties to the proceeding are not entitled to participate in such a decision.

Accordingly, the NCUA adopts this section as proposed. –

Section 747.11 Service of Papers

The proposal changed this section by permitting parties, the NCUA Board, and ALJs to serve a subpoena on a party by delivering it to a person of suitable age and discretion at a party's place of work.

The NCUA received one comment on this section. The commenter supported the intent of the proposal, but asserted that the provision permitting service at a person's place of work was too broad to be effective, particularly where a financial institution has numerous branches.

The NCUA interpreted the phrase ''person's place of work'' as used in the proposal to mean the physical location at which an individual works and not as any office of the corporation or association that employs the person. To avoid confusion, the NCUA has added specific reference to physical location to the regulatory text. In addition, the final rule states expressly that only an individual, not a corporation or association, may be served at a residence or place of work.

The same comment points out, however, that the former Uniform Rules did not expressly permit certain methods of service that are useful for serving a corporation or other association. The final rule, therefore, permits service on a party corporation or other association by delivery of a copy of a notice to an officer, managing or general agent, or to any other agent authorized by appointment or by law to receive service of process. Even though a credit union technically may not satisfy the definition of a corporation or other association, it is to be treated as such for purposes of service under this rule.

The final rule also provides that, if the agent is one authorized by a statute to receive service and the statute so requires, the serving party must also mail a copy to the party. The final rule also restructures this provision for clarity.

Section 747.12 Construction of Time Limits

The proposal clarified that the additional time allotted for responding to papers served by mail, delivery service, or electronic media transmission under § 747.12(c) is not included in determining whether an act is required to be performed within ten

days. The proposal also clarified that additional time allotted for responding to papers served by mail, delivery, or electronic media transmission is counted by calendar days and, therefore, a party must count Saturdays, Sundays, and holidays when calculating a time deadline.

The NCUA received one comment on this section, asserting that Saturdays, Sundays and holidays should be excluded when calculating a time deadline because small credit unions and U.S. Post Offices frequently are not open on those days. This comment addresses time deadlines generally, whereas the proposed amendment counts Saturdays, Sundays and holidays only when calculating *extra* time added under § 747.12(c) for responding to papers served by mail, delivery, or electronic media transmission. The proposed amendment does not affect the current rule excluding those days from deadlines of ten days or less, and including them in deadlines of more than ten days. NCUA adopts the section as proposed.

Section 747.20 Amended Pleadings

The proposal changed this section to permit a party to amend its pleadings without leave of the ALJ and to permit the ALJ to admit evidence over the objection that the evidence does not fall directly within the scope of the issues raised by a notice or answer.

The NCUA received one comment on this section. The commenter asserted that the change could unduly prejudice a party if a notice were amended to add or delete allegations immediately prior to the hearing. The commenter expressed concern that the amendment would give a party insufficient time to seek additional discovery or file for summary judgment.

The regulatory text gives the ALJ discretion to revise the hearing schedule to ensure that no prejudice results from last minute amendments to a notice. The NCUA believes this approach is adequate to avoid prejudice to a party and, therefore, the NCUA adopts this section as proposed.

Section 747.24 Scope of Document Discovery

The former Uniform Rules were silent on the use of interrogatories. The proposal expressly prohibited parties from using interrogatories on grounds that other discovery tools are more efficient and less burdensome and therefore more appropriate to administrative adjudications. NCUA received two comments on this subsection. One urged that interrogatories not be expressly prohibited so that they would be available for use on a limited basis. The other urged that interrogatories be expressly permitted without limitation. Both comments are effectively moot in failing to recognize that NCUA's current Local Rule of Practice and Procedure, with a single narrow exception, already expressly prohibits all forms of discovery other than production of documents. 12 CFR 747.100.

The proposal also sought to focus document discovery requests so that they are not unreasonable, oppressive, excessive in scope, or unduly burdensome to any of the parties. Accordingly, the proposal preserved the former rule's limitation on document discovery by permitting discovery only of documents that have material relevance. However, the proposal specifically provided that a request should be considered unreasonable, oppressive, excessive in scope, or unduly burdensome if, among other things: (1) It fails to include justifiable limitations on the time period covered and the geographic locations to be searched; (2) the time provided to respond in the request is inadequate; or (3) the request calls for copies of documents to be delivered to the requesting party and fails to include the requestor's written agreement to pay in advance for the copying, in accordance with § 747.25.

Under the proposal, the scope of permissible document discovery is not as broad as that allowed under Rule 26(b) of the Federal Rules of Civil Procedure (28 U.S.C. app.). Historically, given the specialized nature of enforcement proceedings in regulated industries, discovery in administrative proceedings has not been as expansive as it is in civil litigation.

The NCUA received one comment on this subsection, urging that the Federal Rule 26(b) standard in the current subsection be retained. The agencies' experience with document discovery in their administrative proceedings has been that substantial time and resources are squandered on extraneous document discovery. A standard somewhat more restrictive than that of Federal Rule 26(b) is needed to reasonably confine document discovery. Accordingly, the NCUA adopts this subsection as proposed.

Section 747.25 Request for Document Discovery From Parties

The NCUA proposed several changes to § 747.25. First, the proposal sought to reduce unnecessary burden by permitting a party to: (1) Respond to document discovery either by producing documents as they are kept in the ordinary course of business or by organizing them to correspond to the categories in a document request; and (2) identify similar documents by category when they are voluminous and are protected by the deliberative process, attorney-client, or attorney work-product privilege.

The proposal also amended § 747.25 to permit a party to require payment in advance for the costs of copying and shipping requested documents; and clarified that, if a party has stated its intention to file a timely motion for interlocutory review, the ALJ may not release, or order a party to produce, documents withheld on grounds of privilege until the motion for interlocutory review has been decided.

The NCUA received two comments on this section. One comment suggested that a request for interlocutory review should automatically stay the proceeding. Under § 747.28(d) of the Uniform Rules, a party may request that a proceeding be stayed during the pendency of an interlocutory review, and the ALJ has the discretion to decide whether a stay is appropriate. The NCUA believes that this procedure adequately protects the parties. For this reason and to avoid adding unnecessary delays in the administrative proceedings, the NCUA declines to provide for an automatic stay whenever a party requests interlocutory review.

The second comment asserted that permitting the NCUA to require payment in advance for document copying and shipping costs would give the NCUA an advantage over other creditors if the party is bankrupt following the administrative hearing. The commenter does not assert that it is a violation of the bankruptcy laws for the NCUA or any other creditor to require prepayment for products or services. Moreover, the NCUA believes that the situations causing the commenter's concern would be very rare. Accordingly, the NCUA adopts this section as proposed.

Section 747.27 Deposition of Witness Unavailable for Hearing

The proposal clarified that a party may serve a deposition subpoena on a witness who is unavailable by serving the subpoena on the witness's authorized representative. The final rule does not include this proposed change because, in § 747.11(d), the final rule expressly permits a party to serve a subpoena by delivering the subpoena to an agent, which includes delivery to an authorized representative. The proposed change to § 747.27 would be redundant. The NCUA received no comments on

this section. The final rule does not, therefore, change this provision.

Section 747.33 Public Hearings

The proposal changed this section to specify that a party must file a motion for a private hearing with the NCUA Board, and not the ALJ, but must serve the ALJ with a copy of the motion.

The NCUA received no comments on this section, which is adopted as proposed.

Section 747.34 Hearing Subpoenas

The former Uniform Rules did not specifically require that a party inform all other parties when a subpoena is issued to a non-party. The proposal required that, after a hearing subpoena is issued by the ALJ, the party that applied for the subpoena must serve a copy of it on each party. Under the proposal, any party may move to quash any hearing subpoena and must serve the motion on each other party.

The NCUA received no comments on this section, which is adopted as proposed.

Section 747.35 Conduct of Hearings

The proposal limited the number of counsel permitted to examine a witness and clarified that hearing transcripts may be obtained only from the court reporter. The former Uniform Rules were silent on these issues.

The NCUA received no comments on this section, which is adopted as proposed.

Section 747.37 Post-hearing Filings

The proposal changed the title of this section from ''Proposed findings and conclusions'' to ''Post-hearing filings'' to describe more accurately the content of the section.

The proposal also moved, from § 747.35(b) to § 747.37(a), the provision that requires the ALJ to serve each party with notice of the filing of the certified transcript of the hearing (including hearing exhibits). The proposal added a requirement that the ALJ must use the same method of service for this notice for each recipient.

Finally, the proposal clarified that the ALJ may, when appropriate, permit parties more than the allotted 30 days to file proposed findings of fact, proposed conclusions of law, and a proposed order.

The NCUA received no comments on this section, which is adopted with a minor technical change.

Section 747.38 Recommended Decision and Filing of Record

Under the former Uniform Rules, the ALJ was not required to file an index of the record when he filed the record with the NCUA Board. The proposal added this requirement and reorganized this section to improve its clarity.

The NCUA received no comments on this section, which is adopted as proposed.

Technical Changes

The final rule makes several technical changes to the proposal that make the final rule specific to the NCUA. These changes appear throughout the rule text. For example, bracketed references to the ''agency head'' have been replaced with ''the NCUA Board'' and the blank part designation before each section number has been filled in with ''747.''

III. Rationale for Expedited Effective Date

The effective date of NCUA's final rule, June 5, 1996, is less than the thirty days from publication. The APA requires thirty days' notice of effectiveness, but permits that requirement to be waived upon a showing of good cause. 5 U.S.C. 553(d)(3). Good cause exists in this case for making NCUA's final rule effective June 5. The Uniform Rules were originally developed and recently revised jointly with the other agencies. The purpose of the June 5 effective date for NCUA's final rule adopting the revisions is to conform to the effective date of the other agencies' final rules. No party to an NCUA administrative proceeding governed by the Uniform Rules will be prejudiced by the June 5 effective date because the revisions adopted in the final rule apply only to formal administrative proceedings commenced (through filing of a notice of charges) after the effective date (*see* 58 FR 37766). Formal administrative proceedings pending on or before the effective date will not be affected by the revisions.

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, the NCUA hereby certifies that this final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

This final rule imposes only procedural requirements in administrative adjudications. It contains no substantive requirements. It improves the Uniform Rules of Practice and Procedure and facilitates the orderly determination of administrative proceedings. The changes in this final rule are primarily clarifications and impose no significant additional burdens on regulated institutions, parties to administrative actions, or counsel.

V. Executive Order 12612

This final rule, like the current part 747 it is replacing, will apply to all Federally insured credit unions. The NCUA Board, pursuant to Executive Order 12612, has determined, however, that this joint proposed rule will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among various levels of government. Further, this joint proposed rule will not preempt provisions of state law or regulations.

VI. Effective Date

Section 302 of the Riegle Community Development and Regulatory Improvement Act 1994 delays the effective date of regulations promulgated by the Federal banking agencies that impose additional reporting, disclosure, or other new requirements to the first date of the first calendar quarter following publication of the final rule. The NCUA believes that Section 302 is not applicable to this final rule, because the regulation does not impose any additional reporting or other requirements not already contained in the current version of the Uniform Rules.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701 and 705

Community Development Revolving Loan Program for Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final amendments.

SUMMARY: The purpose of the Community Development Revolving Loan Program for Credit Unions is to make reduced rate loans and provide technical assistance to both Federal and State-chartered credit unions serving low-income communities. The NCUA Board is issuing final amendments to this regulation to: eliminate the limits on technical assistance that may be provided per year to participating credit unions; clarify that student credit unions may not participate in the Program; clarify that credit unions may receive up to $300,000 in loans in the aggregate at any one time; and require additional documentation from nonfederally insured credit unions that may wish to participate in the Program. The NCUA Board is also issuing a technical amendment to another regulatory provision to conform it to the revised Program regulations.

EFFECTIVE DATE: October 1, 1996.

FOR FURTHER INFORMATION CONTACT: Joyce Jackson, Director, Office of Community Development Credit Unions, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone (703) 518–6610 or Michael J. McKenna, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION: The purpose of the Community Development Revolving Loan Program (''Program'') is to make reduced rate loans and provide technical assistance to Federal and State-chartered credit unions serving low-income communities so that they may provide needed financial services and help to stimulate the economy in the community served. Although the Program has functioned well, the Board proposed four amendments to improve and clarify certain aspects of the Program. The NCUA Board issued proposed amendments to the Program on January 25, 1996. 61 FR 4239 (February 5, 1996). Four comment letters were received. Three commenters were state credit union leagues and one commenter was a national trade association. All of the commenters supported the proposed amendments.

Section 705.3 Definitions

This section, among other things, defines the term low-income members. In documenting its low-income membership, a credit union that serves a geographic area where a majority of residents fall at or below the annual income standard is presumed to be serving predominantly low-income members. In applying the low-income standard, the Regional Director must use specifically defined differentials for geographical areas with a higher cost of living. These differentials were originally obtained from a list maintained by the Bureau of Labor Statistics, as updated by the Employment and Training Administration. In order to recognize geographic economic differences, eleven cities that were above the national average for the lower level standard of living numbers were provided differentials to be applied by the Regional Director. NCUA requested comment on updating the differentials. The commenters did not suggest any changes. The Board does not believe there is any compelling reason to change the differentials at this time. However, to clarify the term ''geographic area'' and to provide for consistent application of agency policy, the Board believes that the geographic area definition should be based on either the Consolidated Metropolitan Statistical Area (CSMA) or Metropolitan Statistical Area (MSA) classification, as appropriate, that are used by the Office of Management and Budget (OMB) or defined by the Census Bureau.

Some in the credit union community have questioned whether student credit unions are eligible to participate in the Program. The preamble to the final 1993 amendments stated that although ''student federal credit unions are 'low-income credit unions' for purposes of receiving nonmember deposits, they do not qualify for participation in the Program because they are not specifically involved in the stimulation of economic development activities and community revitalization efforts.'' 58 FR 21642, 21645 (April 23, 1993). The Board proposed to amend Section 705.3(b) to clarify that student credit unions may not participate in the Program. All four commenters approved of this proposal. Accordingly, the Board is adopting this clarification in the final rule.

Section 705.5 Application for Participation

Because NCUA does not regulate nonfederally insured state chartered credit unions, the Board proposed that a nonfederally insured credit union provide in its application for Program participation a copy of its most recent outside audit report and proof of deposit and surety bond insurance which states the maximum insurance levels permitted by the policies, so that NCUA may properly consider the application. This proposal would simply require documentation that is comparable to the information accessible to NCUA for federally insured credit unions. All four commenters supported this proposal. The Board is also changing the term ''delinquent loan list'' to ''schedule of delinquent loans'' so that the information submitted will be comparable to information NCUA obtains from federally insured credit unions. The Board is also streamlining this section so that the requirements found in proposed Section 705.5(b) (iii) through (v) are simply stated in Section 705.5(b)(iii). Otherwise, the Board is adopting the proposed amendment in final.

Section 705.7 Loans to Participating Credit Unions

Section 705.7 currently states that a participating credit union is eligible ''to receive up to $300,000, as determined by the NCUA Board, in the form of a loan from the Community Development Revolving Loan Fund for Credit Unions.'' Some have questioned whether this means that a credit union may receive more than one $300,000 loan under the Program. The Board's proposal clarified that because of the Program's limited funds that the aggregate dollar amount of outstanding loans to one credit union is limited to $300,000. All four commenters supported this proposal. Accordingly, the Board is adopting the proposed amendment in final.

Section 705.10 Technical Assistance

Under the current Section 705.10, technical assistance may not exceed $120,000 per year. The Board proposed to eliminate the dollar threshold on technical assistance in the anticipation that available earnings may exceed $120,000. Such a change would provide NCUA greater flexibility in providing technical assistance. All four commenters supported the proposed amendment. Accordingly, the Board is adopting the proposed amendment in final.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic

impact a proposed regulation may have on a substantial number of small credit unions (primarily those under $1 million in assets). The final amendments generally clarify operational issues. The one significant change regarding technical assistance is expected to benefit credit unions by increasing the available pool of funds for technical assistance. Accordingly, the Board determines and certifies that this final rule does not have a significant impact on a substantial number of small credit unions and that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that the final amendments do not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget (OMB).

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its action on state interests. The Program is implemented in its entirety by the NCUA. The final amendments will permit more funds to be available for technical assistance to all credit unions, including state-chartered credit unions. The final amendments impose a minimal burden on nonfederally insured state chartered credit unions that wish to participate in the Program. The amendments will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of powers among the various levels of government.

List of Subjects

12 CFR Part 701

Credit, Credit unions.

12 CFR Part 705

Community development, Credit unions, Loans programs-housing and community development, Reporting and recordkeeping requirements, Technical assistance.

By the National Credit Union Administration Board on September 18, 1996.

Becky Baker,

Secretary of the Board.

12 CFR Parts 701, 709 and 741

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The final rule allows credit unions serving predominantly low-income members (LICU) to raise secondary capital from foundations and other philanthropic-minded institutional investors. The rule will enable LICUs to make more loans and improve other financial services for the groups and communities they serve. The rule also allows federal- and state-chartered LICUs to offer secondary capital accounts and incorporates the existing regulatory provisions concerning the designation of low-income status. The rule also amends NCUA's regulations so that secondary capital accounts are last in payout priorities in the event of an involuntary liquidation.

EFFECTIVE DATE: September 27, 1996.

FOR FURTHER INFORMATION CONTACT: Joyce Jackson, Director, Office of Community Development Credit Unions, at 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone (703) 518–6610, or David Marquis, Director, or Stephen Austin, Acting Deputy Director, Office of Examination and Insurance, both at the above address or telephone (703) 518–6360, or Robert M. Fenner, General Counsel, at the above address or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

Background

On February 2, 1996, the NCUA Board issued an interim final rule (''Interim Rule''), 61 FR 3788, that authorized LICUs to accept funds as secondary capital from nonnatural persons and philanthropic institutional investors. The Board issued the Interim Rule to achieve the following goals: to assist LICUs in achieving their purpose of serving members and communities in financial need; to ensure that any authorized secondary capital will actually function as capital and be available to absorb losses; to ensure that investors in secondary capital understand the nature of their investment and the risk they are undertaking; and to eliminate any potential risk to the NCUSIF and insured credit unions generally as a result of this activity.

Summary of Comments and Discussion of Issues

NCUA received six comment letters: three from state credit union leagues; two from national credit union trade associations; and one from an accounting trade group. The five credit union commenters expressed strong support for the Interim Rule with one commenter viewing the Interim Rule ''as the most important regulatory innovation of the last two decades in addressing the special needs of [LICUs].'' The accounting trade group neither supported nor opposed the Interim Rule.

Use of Secondary Capital To Replenish Operating Losses

Two commenters expressed support for the Interim Rule's provisions that required LICUs to use the secondary capital to cover the LICU's operating losses. However, both commenters disagreed with NCUA's decision to prohibit LICUs from replenishing the secondary capital when the LICU regained financial health. One of the commenters questioned NCUA's rationale and the other commenter asked the NCUA to reexamine its position. The latter commenter believed NCUA could establish safeguards so the replenishment of secondary capital would be subordinate to the LICU's other goals, such as reinstituting dividends and building capital. The commenter also believed NCUA's position unfairly penalized investors and decreased the secondary capital's attractiveness.

Permitting LICUs to replenish secondary capital accounts once financial health has been regained would defeat the purpose for establishing secondary capital. The goal of secondary capital is to enhance capital positions. The potential growth of primary capital could be slowed by allowing LICUs to replenish investor funds in the event those funds are depleted. Additionally, permitting replenishment could be interpreted as a ''guaranteed return of principal'' by the investor which was not the Board's original intent.

Secondary Capital as Equity

Two commenters objected to the Interim Rule's provisions that required LICUs to treat secondary capital as equity. Instead, the commenters believed that LICUs should treat secondary capital as debt according to GAAP. One commenter stated that classifying secondary capital as equity was misleading and recommended that NCUA require LICUs to exclude non-GAAP financial information from the LICU's financial statements. The commenter also strongly encouraged NCUA to follow the other federal financial regulators and conform all of NCUA's regulatory accounting practices to GAAP. The other commenter requested additional guidance from NCUA since many LICUs and auditing firms will not be familiar with the accounting issues associated with secondary capital.

The Board has considered the commenter's position, and acknowledges that while secondary capital accounts have characteristics of both debt and equity, in the final analysis, it believes secondary capital is more analogous to equity. Thus, for reporting purposes, LICUs should record secondary capital accounts consistent with Accounting Bulletin 96–1 (the ''Bulletin''), which establishes the accounting entries for secondary capital. The Bulletin requires secondary capital to be treated as part equity and part subordinated debt based on a sliding scale. The Board anticipates that most LICUs will not be seeking audit opinions on their financial statements nor posting GAAP statements for members or other third-party reliance. Most LICUs financial statement reporting efforts will be directed to meeting NCUA regulatory requirements and thus, our approach is not at odds with the other federal banking agencies since they, too, have preserved their option to adopt regulatory reporting requirements for supervisory purposes.

Sliding Scale

One commenter objected to the requirement that LICUs add a footnote to their financial statements reflecting the secondary capital's value as a percentage of its face value, on a five year sliding scale. The commenter suggested the footnote should state the secondary capital's total dollar amount and maturity date. According to the commenter, their proposed method would be consistent with GAAP and reflect the economic reality that all of the secondary capital would be available to absorb losses until maturity.

The Bulletin specifically provides for two separate accounts for recognizing secondary capital. The first, uninsured secondary capital (account #925) shows the amount of secondary capital having a maturity greater than 5 years. Subordinated CDCU Debt (account #867) recognizes the secondary capital accounts with maturities of less than 5 years. The rule establishes a sliding scale for the capital value of accounts with less than 5 years remaining maturity. The Board believes a footnote

disclosure recognizing the secondary capital's total dollar amount and maturity date would be appropriate. As a result, the final rule directs LICUs to reflect the secondary capital's full amount in a footnote to its balance sheet, and reflect the secondary capital's capital value based on the sliding scale in the LICU's balance sheet.

Requiring Secondary Capital as a Condition of Charter or Letter of Understanding and Agreement

Finally, two commenters expressed concerns that the rule may result in tougher requirements for new or troubled LICUs. Both commenters believed that NCUA should not require a LICU to obtain secondary capital before the NCUA granted a charter or as a condition of a Letter of Understanding and Agreement. One commenter noted that the Interim Rule did not require LICUs to offer secondary capital and believed that NCUA should only direct a LICU to obtain secondary capital in rare instances.

The Board strongly believes secondary capital will help support greater lending and financial services for members of LICUs; however, it was never the Board's intention to require secondary capital as a condition for new LICUs. The decision to use secondary capital accounts is within the discretion of the LICU.

Final Rule

The final rule adopts with minor modifications the Interim Rule published on February 2, 1996. (61 FR 3788).

Regulatory Procedures

Regulatory Flexibility Act

The NCUA Board certifies that this rule will not have a significant impact on a substantial number of small credit unions. The rule affects only low-income designated credit unions, and imposes no mandatory regulatory burden on those credit unions. Rather, it increases flexibility by providing a new method of raising capital through secondary capital accounts. Accordingly, a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The collection of information requirements contained in the rule were approved by the Office of Management and Budget under OMB Control No. 3133–0140. Federally insured credit unions are not required, pursuant to the terms of the Paperwork Reduction Act, to comply with paperwork requirements until OMB approval and a OMB control number are received. However, NCUA expected LICUs that chose to offer secondary capital accounts, as a matter of safety and soundness, to adopt written plans, forward a copy of the LICU's plan to the Regional Director (and state supervisor in the case of state credit unions) and use account contract documents and disclosure forms that meet the requirements of this rule in every respect.

Written comments on the collection of information should be sent to the Office of Management and Budget, OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, DC 20503. Attn: Alexander Hunt. The collection of information requirements relating to the final rule are found at 12 CFR 701.34(b) (1) and (11). NCUA believes these requirements are essential both to ensure the safe and sound operation of a secondary capital program and to ensure that account holders fully understand the nature of their investment in the credit union and the risks involved. The likely recordkeepers are Federally-insured credit unions with a low-income designation.

Estimated number of respondents and/or recordkeepers: 50.

Estimated average annual burden hours per respondent/recordkeeper: 3 hours.

Estimated total annual reporting and recordkeeping burden: 150 hours.

Start-up costs to respondents: None.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effects of its actions on state interests. This rule has no adverse effects on state interests. The rule provides additional authority for federally insured state chartered credit unions, but only to the extent not inconsistent with state law and regulations. The NCUA Board, however, specifically requested the comments of State credit union regulators to obtain their guidance in how the rule may affect their credit unions. However, no State credit union regulator commented on the Interim Rule.

List of Subjects in 12 CFR Part 701

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on September 18, 1996.

Becky Baker,

Secretary of the Board.

12 CFR Part 711

Management Official Interlocks

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: NCUA is revising its rules regarding management interlocks between credit unions and other types of depository institutions. The final rule, like the current regulation, does not apply when a credit union shares a management official with another credit union. The final rule conforms the interlocks rules to recent statutory changes, modernizes and clarifies the rules, and reduces unnecessary regulatory burdens where feasible, consistent with statutory requirements.

EFFECTIVE DATE: September 27, 1996.

FOR FURTHER INFORMATION CONTACT: Jeffrey Mooney, Staff Attorney (703/518–6563), Office of General Counsel, or Kimberly Iverson, Program Officer (703/518–6375), Office of Examination and Insurance.

SUPPLEMENTARY INFORMATION:

Background

The Depository Institution Management Interlocks Act (12 U.S. C. 3201 *et seq.*) (Interlocks Act) prohibits certain management interlocks between depository institutions. The Interlocks Act exempts interlocking arrangements between two credit unions and therefore, in the case of credit unions, only restricts interlocks between credit unions and other depository institutions—banks and savings associations.

The Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI Act) amended the Interlocks Act by removing NCUA's broad authority to exempt otherwise impermissible interlocks and replacing it with the authority to exempt interlocks under more narrow circumstances. The CDRI Act also required a depository organization with a ''grandfathered'' interlock to apply for an extension of the grandfather period if the organization wanted to keep the interlock in place.

On March 25, 1996, the NCUA Board (Board) published a notice of proposed rulemaking (proposal) (61 FR 12043) to implement these statutory changes. In addition, the proposal permitted interlocks involving two institutions located in the same relevant metropolitan statistical area (RMSA) if the institutions were not also located in the same community and if at least one of the institutions had total assets of less than $20 million. Finally, the proposal streamlined and clarified NCUA's interlocks rules in various respects.

The Final Rule and Comments Received

NCUA received eight comment letters; four from state leagues, three from credit unions, and one from a national trade association. Seven of the eight commenters supported the proposal. The commenter that objected to the proposal thought the changes were unnecessary. A few commenters, while supporting the proposal, requested guidance or suggested changes as discussed later in this preamble. Most of the provisions in the proposal received either no comments or favorable comments. Accordingly, NCUA has adopted, with minor modifications, the changes to the interlocks rules that were set forth in the proposal.

Authority, Purpose, and Scope

This section in NCUA's final rule identifies the Interlocks Act as the statutory authority for the management interlocks regulation. It also states that the purpose of the rules governing management interlocks is to foster competition between unaffiliated institutions.

One commenter asked NCUA to include a statement that ''this part does not apply to interlocking arrangements between credit unions.'' Language to that effect is provided in section 711.1(c).

Definitions

Anticompetitive Effect

The final rule defines the term ''anticompetitive effect'' to mean ''a monopoly or substantial lessening of competition,'' a definition derived from the Bank Merger Act (12 U.S.C. 1828(c)). The term ''anticompetitive effect'' is used in the Regulatory Standards exemption. Under the Regulatory Standards exemption, NCUA may approve a request for an exemption to the Interlocks Act if, among other things, the agency finds that continuation of service by the management official does not produce an anticompetitive effect with respect to the affected institution.

The statute does not define the term ''anticompetitive effect,'' nor does the legislative history to the CDRI Act point to a particular definition. The context of the Regulatory Standards exemption suggests that NCUA should apply the term ''anticompetitive effect'' in a manner that permits interlocks that present no substantial lessening of competition. By prohibiting an interlock that would result in a monopoly or substantial lessening of competition, the definition preserves the free flow of credit and other financial services that the Interlocks Act is designed to protect.

Since the term anticompetitive effect is not used by the credit union industry, NCUA requested comments on whether another definition would be more appropriate. One commenter suggested that NCUA define monopoly and substantial lessening of competition by using percentages. The Board believes a percentage system would be arbitrary and has not made the suggested change.

Two commenters asked NCUA to clarify what the agency would consider an anticompetitive effect. The Board anticipates that it will make this determination on a case-by-case basis. Nevertheless, NCUA will follow Justice Department guidelines and precedents established by the financial institution regulators where appropriate.[1]

Area Median Income

The final rule defines ''area median income'' as the median family income for the metropolitan statistical area (MSA) in which an institution is located or the statewide nonmetropolitan median family income if an institution is located outside an MSA. The term ''area median income'' is used in the definition of ''low- and moderate-income areas,'' which in turn is used in the implementation of the Management Consignment exemption.

Critical

The final rule defines ''critical'' as being ''important to restoring or maintaining a depository organization's safe and sound operations.'' The term ''critical'' is used in the Regulatory Standards exemption. Under that exemption, NCUA must find that a proposed management official is critical to the safe and sound operations of the affected institution. 12 U.S.C. 3207(b)(2)(A).

Neither the statute nor its legislative history defines ''critical.'' NCUA is concerned that a narrow interpretation of this term would nullify the Regulatory Standards exemption. If someone were ''critical'' to the safe and sound operations of an institution only if the institution would fail but for the service of the person in question, the exemption would have little relevance, because the standard would be impossible to meet. Given that Congress

[1] *See e.g.*, the Office of the Comptroller of the Currency's (OCC) Bank Merger Competitive Analysis Screen (OCC Advisory Letter 95–4, July 18, 1995); Department of Justice Merger Guidelines (49 FR 26823, June 29, 1984) (applied by the Federal Reserve Board (FRB)); and Federal Deposit Insurance Corporation (FDIC) Statement of Policy: Bank Merger Transactions (54 FR 39045, Sept. 22, 1989).

clearly intended for the Regulatory Standards exemption to permit interlocks under some circumstances, the question thus becomes how to define those circumstances.

The Board believes that the definition of critical adopted in this final rule is consistent with the legislative intent by insuring that only persons of demonstrated expertise and importance to the institution's safe and sound operations may serve pursuant to a Regulatory Standards exemption.

One commenter supported the definition as proposed. Two commenters, however, asked NCUA to clarify when the agency would consider a management official critical. As discussed below, the Board has established presumptions to determine when a person is critical to an institution, therefore, it does not believe further clarification is necessary.

Depository Institution

The final rule makes no substantive change to the definition of ''depository institution.''

Low- and Moderate-Income Areas

The final rule defines this term as a census tract (or, if an area is not in a census tract, a block numbering area delineated by the United States Bureau of the Census) in which the median family income is less than 100 percent of the area median income. This term is used in the Management Consignment exemption that permits an otherwise impermissible interlock if the interlock would improve the provision of credit to a low- and moderate-income area. The final rule clarifies that NCUA will evaluate whether an area is low- or moderate-income by comparing the median family income for the census tract to be helped (or, if there is no census tract, the block numbering area delineated by the United States Bureau of the Census) with the area median income. Income data will be derived from the most recent decennial census.

Management Official

The final rule defines ''management official'' to include a senior executive officer, a director, a branch manager, a trustee of an organization under the control of trustees, or any person who has a representative or nominee serving in such capacity. The definition excludes (1) a person whose management functions relate either exclusively to the business of retail merchandising or manufacturing or principally to business outside the United States of a foreign commercial bank and (2) a person excluded by section 202(4) of the Interlocks Act (12 U.S.C. 3201(4)).

The final rule removes the phrase ''an employee or officer with management functions,'' which appeared in the former rule. In its place, NCUA has used the term ''senior executive officer'' as defined by each agency in its regulation pertaining to the prior notice of changes in senior executive officers, which implement section 212 of the Federal Credit Union Act (FCU Act) (12 U.S.C. 1790a) as added by section 914 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Pub. L. No. 101–73, 103 Stat. 183). NCUA has made this change to eliminate the uncertainty and attendant compliance burden created by the ambiguous term ''management functions.'' The final rule incorporates specific illustrative examples already found in NCUA's regulations of positions at depository organizations that will be treated as senior executive officers. *See* 12 CFR § 701.14. The Board believes that this definition will allow depository organizations to identify impermissible interlocks with greater certainty and thus will enhance compliance.

One commenter asked NCUA to place the text of the definition of senior executive officer already found in section 701.14 in section 711.2. Another commenter asked NCUA to specifically exclude compliance officers from the definition of management official.

NCUA has not adopted either suggested change. First, NCUA does not believe adding the text of section 701.14 to section 711.2 is necessary. References to other sections are common and do not increase regulatory burden. Second, while NCUA believes that in most instances a compliance officer will not be considered a management official, that determination should be made after the individual's duties and responsibilities have been evaluated.

Relevant Metropolitan Statistical Area

The final rule, like its predecessor, defines ''RMSA'' as an MSA, a primary MSA, or a consolidated MSA that is not comprised of designated primary MSAs. However, the final rule clarifies that this definition will be used to the extent that the Office of Management and Budget (OMB) defines and applies the terms MSA, primary MSA, and consolidated MSA. This change reflects the fact that OMB defines ''consolidated MSA'' to include two or more primary MSAs. Given that a consolidated MSA, by OMB's definition, is comprised of primary MSAs, the reference to a consolidated MSA in the Interlocks Act and NCUA's regulations is inappropriate. The final rule enables NCUA to implement the statute in a way that complies with both the spirit and the letter of the Interlocks Act.

Representative or Nominee

The final rule defines ''representative or nominee'' as someone who serves as a management official and has an obligation to act on behalf of someone else. The final rule removes the rest of the definition that appeared in the former rule, however, and inserts a statement that NCUA will find that someone has an obligation to act on behalf of someone else *only* if there is an agreement (express or implied) to do so. This change clarifies that the determination of whether someone serves a representative or nominee will depend on whether there is a basis to conclude that an agreement exists to act on someone's behalf.

Prohibitions

The former rule prohibited interlocks under three circumstances. First, no two unaffiliated depository organizations may have an interlock if they (or their depository institution affiliates) have depository institution offices in the same *community*. Second, a depository organization may not have an interlock with any unaffiliated depository organization if either depository organization has assets of $20 million or more and the depository organizations (or depository institution affiliates of either) have depository institution offices in the same RMSA.[2] Third, if a depository organization has total assets exceeding $1 billion, it (and its affiliates) may not have an interlock with any depository organization with total assets exceeding $500 million (or affiliate thereof), regardless of location.

The final rule amends the restriction applicable to institutions with assets equal to or exceeding $20 million to better conform to the purposes of the Interlocks Act. Whereas the prior rule prohibited interlocks in an RMSA if *one* of the organizations had total assets of $20 million or more, the final rule applies the RMSA-wide prohibition only if *both* organizations have total assets of $20 million or more. Interlocks within a *community* involving unaffiliated depository organizations will continue to be prohibited, regardless of the size of the organizations.

The Board believes that this change is consistent with both the language and the intent of the Interlocks Act. While

[2] A ''community'' as that term is defined in the rule is smaller than an RMSA. There may be several communities in one RMSA.

the statute uses the plural ''depository institutions'' in section 203(1) of the Interlocks Act (12 U.S.C. 3202(1)), the wording in context is ambiguous and neither the statute nor its legislative history compels the conclusion that the interlock must involve two institutions with less than $20 million in assets before the less restrictive prohibition applies.

The Interlocks Act seeks to prohibit interlocks that could enable two institutions to engage in anticompetitive behavior. However, an institution with total assets of less than $20 million is likely to derive most of its business from the community in which it is located and is unlikely to compete with institutions that do not have offices in that community. Therefore, an interlock involving one institution with assets under $20 million and another institution with assets of at least $20 million not in the same community is not likely to lead to the anticompetitive conduct that the Interlocks Act is designed to prohibit.

The Board believes that this change will promote rather than inhibit competition. Expanding the pool of managerial talent for institutions with assets under $20 million could enhance the ability of smaller institutions to compete by improving the management of these institutions.

One commenter objected to the proposed change asserting that it was unnecessary. For the reasons stated above, NCUA disagrees with the commenter and has included the changes in the final rule.

Interlocking Relationships Expressly Permitted by Statute

The final rule states the exemptions found in 12 U.S.C. 3204 (1)–(8). The final rule reorders the exemptions set forth in the current regulation in order to conform the list of exemptions to the list set forth in the Interlocks Act.

Regulatory Standards Exemption

The final rule sets forth the requirements that a depository organization must satisfy in order to obtain a Regulatory Standards exemption. The rule implements the requirement regarding certification by allowing a depository organization's board of directors (or the organizers of a depository organization that is being formed) to certify to NCUA that no other qualified candidate has been found after undertaking reasonable efforts to locate qualified candidates who are not prohibited from service under the Interlocks Act. If read narrowly, the Interlocks Act could require a depository organization to evaluate every person in a given locale that might be qualified and interested. This would create a requirement that, in practice, would be impossible to satisfy. Given that Congress would not have included an exemption that would have no practical application, NCUA believes that the ''reasonable efforts'' standard is consistent with the legislative intent.

The final rule also sets forth a presumption that NCUA will apply when reviewing an application for a Regulatory Standards exemption.[3] NCUA will presume that a person is critical to an institution's safe and sound operations if NCUA also approved that individual under section 914 of FIRREA and the institution in question either was a newly chartered institution, failed to meet minimum capital requirements, or otherwise was in a ''troubled condition'' as defined in the reviewing agency's section 914 regulation at the time the section 914 filing was approved.

The final rule also addresses the duration of an interlock permitted under the Regulatory Standards exemption. The statute does not require that these interlocks terminate. In light of this open-ended grant of authority, NCUA has not adopted a specific term for a permitted exemption. Instead, NCUA may require an institution to terminate the interlock if NCUA determines that the management official in question either no longer is critical to the safe and sound operations of the affected organization or that continued service will produce an anticompetitive effect. NCUA will provide affected organizations an opportunity to submit information before they make a final determination to require termination of an interlock.

Grandfathered Interlocking Relationships—Removed

Section 338(a) of the CDRI Act authorizes NCUA to extend a grandfathered interlock for an additional five years if the management official in question satisfies the statutory criteria for obtaining an extension.

The final rule removes the sections addressing the grandfather exemption because they are unnecessary and redundant in light of the statute. NCUA did not receive any requests to extend a grandfathered interlock, and individuals who wished to extend the grandfather period had until March 23, 1995 to apply for an exemption.

Management Consignment Exemption

The final rule implements the Management Consignment exemption, set forth in section 209(c) of the Interlocks Act (12 U.S.C. 3207(c)), by restating the statutory criteria with three clarifications. First, the final rule states that NCUA considers a ''newly chartered institution'' to be an institution that has been chartered for less than two years at the time it files an application for exemption. This standard is consistent with NCUA's threshold for determining when an institution is considered newly chartered.

Second, the final rule clarifies that the exemption available for ''minority- and women-owned institutions'' is available for an institution that is owned *either* by minorities *or* women. In analyzing the exemptions to the Interlocks Act that the federal banking agencies have approved, the House Conference Report to the CDRI Act (H.R. Conf. Rep. No. 652, 103d Cong., 2d Sess. 181 (1994)) (Conference Report) states that the types of institutions that have received exemptions include those that are ''owned by women or minorities.'' These exemptions ultimately were codified in the Interlocks Act. Accordingly, NCUA has concluded that Congress intended the Management Consignment exemption to assist institutions owned by women and/or by minorities, but did not intend to require the institution to be owned by both.

Third, the final rule permits an interlock if the interlock would strengthen the management of *either* a newly chartered institution *or* an institution that is in an unsafe or unsound condition. Section 209(c)(1)(C) of the Interlocks Act (12 U.S.C. 3207(c)(1)(C)) permits an exemption if the interlock would ''strengthen the management of newly chartered institutions that are in an unsafe or unsound condition.'' However, this provision contains what appears on its face to be an error, given that an exemption limited to situations involving newly chartered institutions that also are in an unsafe and unsound condition would have no practical utility. NCUA will not approve an application for a credit union charter unless the applicant seeking a charter

[3] OCC, FRB, FDIC and the Office of Thrift Supervision also will presume that an interlock will not have an anticompetitive effect if it involves institutions that, if merged, would not trigger a challenge from agencies on competitive grounds. Generally, the agencies will not object to a merger on competitive grounds if the post-merger Herfindahl-Hirschman Index (HHI) for the market is less than 1800 and the merger increases the HHI by 200 points or less. NCUA will not implement this presumption because there is no statutory authority for credit unions to merge with other types of depository institutions, and the typical HHI analysis does not reflect the shares/deposits held by credit unions, therefore, any HHI analysis involving credit unions would be meaningless.

can demonstrate that the proposed new financial institution will operate in a safe and sound manner for the foreseeable future. While there may be an extraordinary instance where a newly chartered institution immediately experiences unforeseen problems so severe that they threaten the safety and soundness of that institution, there is nothing in the legislative history to suggest that Congress intended to limit the Management Consignment exemption to such rare instances.

Moreover, the legislative history of the CDRI Act suggests that NCUA is to apply the Management Consignment exemption in cases involving either newly chartered institutions or institutions that are in an unsafe or unsound condition. The Conference Report notes that the federal financial institution regulatory agencies have used their exemptive authority to grant exemptions in limited cases where institutions ''are particularly in need of management guidance and expertise to operate in a safe and sound manner.'' *Id*. The Conference Report goes on to state that ''Examples of exceptions permissible under an agency management official consignment program include improving the provision of credit to low- and moderate-income areas, increasing the competitive position of minority- and women-owned institutions, and strengthening he [sic] management of newly chartered institutions *or* institutions that are in an unsafe or unsound condition.'' *Id*. at 182 (emphasis added).

Finally, Congress used the exemptions in NCUA's current rules as the model for the Management Consignment exemption. *See id*. at 181–182. These exemptions distinguish newly chartered institutions from institutions that are in an unsafe or unsound condition. The reference in the CDRI Act's legislative history to the current regulatory exemptions suggests that Congress intended to codify these exemptions.

For these reasons, NCUA will permit Management Consignment exemptions if the management official will strengthen either a newly chartered institution or an institution that is in an unsafe or unsound condition.

The final rule sets forth two presumptions that NCUA will apply in connection with an application for an exemption under the Management Consignment exemption. First, NCUA will presume that an individual is capable of strengthening the management of an institution that has been chartered for less than two years if NCUA approved the individual to serve as a management official of that institution pursuant to section 914 of FIRREA. Second, NCUA will presume that an individual is capable of strengthening the management of an institution that is in an unsafe or unsound condition if NCUA approved the individual to serve under section 914 as a management official of that institution at a time when the institution was in a ''troubled condition.''

NCUA believes that presumptions of suitability are less valid when applied to the other Management Consignment exemptions because there is no reason to conclude that a management official approved under section 914 necessarily will improve the flow of credit to low- and moderate-income areas or increase the competitive position of minority- or women-owned institutions. Moreover, the final rule does not contain a presumption regarding effects on competition, given that this is not a factor to be considered by NCUA when reviewing an application for a Management Consignment exemption.

The final rule sets forth the limits on the duration of a Management Consignment exemption. The Interlocks Act limits a Management Consignment exemption to two years, with a possible extension for up to an additional two years if the applicant satisfies at least one of the criteria for obtaining a Management Consignment exemption. The final rule implements this limitation by requiring interested parties to submit an application for an extension at least 30 days before the expiration of the initial term of the exemption and by clarifying that the presumptions that apply to initial applications also apply to extension applications.

Change in Circumstances

The final rule provides a 15-month grace period for nongrandfathered interlocks that become impermissible due to a change in circumstances. This period may be shortened by NCUA under appropriate circumstances.

Paperwork Reduction Act

The Board has determined that the requirements of the Paperwork Reduction Act do not apply.

Executive Order 12612

This final rule, like the current 12 CFR part 711 it would replace, will apply to all Federally insured credit unions. The Board, pursuant to Executive Order 12612, has determined, however, that this final rule will not have a substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among various levels of government. Further, this final rule will not preempt provisions of State law or regulations.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (RFA) (5 U.S.C. 605(b)), the regulatory flexibility analysis otherwise required under section 603 of the RFA (5 U.S.C. 603) is not required if the head of the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities and the agency publishes such certification and a succinct statement explaining the reasons for such certification in the **Federal Register** along with its final rule.

Pursuant to section 605(b) of the RFA, the Board hereby certifies that this rule will not have a significant economic impact on a substantial number of small entities. The Board expects that this rule will not (1) Have significant secondary or incidental effects on a substantial number of small entities or (2) create any additional burden on small entities. The changes to the exemptions are required by the Interlocks Act. The Board has added presumptions that will streamline and simplify the application procedures for obtaining an exemption from the Interlocks Act prohibitions, and have defined key terms used in the provisions implementing these exemptions in a way that is intended to eliminate any unnecessary burden. As noted in the preamble discussion of the changes made by the final rule, the Board has made substantive changes that will permit more flexibility to institutions with total assets of less than $20 million, clarified the circumstances under which someone will be deemed to be a ''representative or nominee,'' and amended the definition of ''senior management official'' so as to provide greater clarity and to conform this definition with definitions of similar terms used in other regulations.

The impact of these changes will be to minimize, to the extent possible, the costs of complying with this final rule.

List of Subjects in 12 CFR Part 711

Antitrust, Credit unions, Holding companies.

By the National Credit Union Administration Board on September 18, 1996.

Becky Baker,

Secretary of the Board.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 22

[Docket No. 96–20]

RIN 1557–AB47

FEDERAL RESERVE SYSTEM

12 CFR Part 208

[Regulation H, Docket No. R–0897]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 339

RIN 3064–AB66

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 563 and 572

[No. 96–82]

RIN 1550–AA82

FARM CREDIT ADMINISTRATION

12 CFR Part 614

RIN 3052–AB57

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 760

Loans in Areas Having Special Flood Hazards

AGENCIES: Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision, Treasury; Farm Credit Administration; National Credit Union Administration.

ACTION: Joint final rule.

SUMMARY: The Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA) are amending their regulations, and the Farm Credit Administration (FCA) is issuing new regulations, regarding loans in areas having special flood hazards. This action is required by statute to implement the provisions of the National Flood Insurance Reform Act of 1994. This joint final rule establishes new escrow requirements for flood insurance premiums, adds references to the statutory authority and the requirement for lenders and servicers to ''force place'' flood insurance under certain circumstances, enhances flood hazard notice requirements, sets forth new authority for lenders to charge fees for determining whether a property is located in a special flood hazard area, and contains various other provisions necessary to implement the National Flood Insurance Reform Act of 1994.

EFFECTIVE DATES: October 1, 1996; except for subpart S of part 614, which will be effective October 4, 1996, and part 760, which will be effective November 1, 1996.

FOR FURTHER INFORMATION CONTACT:

OCC: Carol Workman, Compliance Specialist (202/874–4858), Compliance Management; Margaret Hesse, Senior Attorney, Community and Consumer Law Division (202/874–5750), or Jacqueline Lussier, Senior Attorney, Legislative and Regulatory Activities Division (202/874–5090), Office of Chief Counsel, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

Board: Diane Jackins, Senior Review Examiner, (202/452–3946), Division of Consumer and Community Affairs; Lawranne Stewart, Senior Attorney (202/452–3513), or Rick Heyke, Attorney (202/452–3688), Legal Division, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Earnestine Hill or Dorothea Thompson (202/452–3544).

FDIC: Mark Mellon, Counsel, Regulation and Legislation Section (202/898–3854), Legal Division, or Ken Baebel, Senior Review Examiner (202/942–3086), Division of Compliance and Consumer Affairs, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

OTS: Larry Clark, Senior Manager, Compliance and Trust Programs (202/906–5628), or Ronald Dice, Program Analyst (202/906–5633), Compliance Policy; Catherine Shepard, Senior Attorney, Regulations and Legislation Division (202/906–7275), Office of Chief Counsel, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

FCA: Robert G. Magnuson, Policy Analyst, Regulation Development (703/883–4498), Office of Examination; or William L. Larsen, Senior Attorney, Legal Counsel Division (703/883–4020), Office of General Counsel, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090. For the hearing impaired only, TDD (703/883–4444).

NCUA: Kimberly Iverson, Program Officer (703/518–6375), Office of Examination and Insurance; or Jeffrey Mooney, Staff Attorney (703/518–6563), Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

SUPPLEMENTARY INFORMATION:

I. Background

The National Flood Insurance Program (NFIP) is administered primarily under two statutes: the National Flood Insurance Act of 1968 (1968 Act) and the Flood Disaster Protection Act of 1973 (1973 Act).[1] The 1968 Act made Federally subsidized flood insurance available to owners of improved real estate or mobile homes located in special flood hazard areas if their community participates in the NFIP. A special flood hazard area (SFHA) is an area within a flood plain having a one percent or greater chance of flood occurrence in any given year. SFHAs are delineated on maps issued by FEMA for individual communities. A community establishes its eligibility to participate in the NFIP by adopting and enforcing floodplain management measures to regulate new construction and by making substantial improvements within its SFHAs to eliminate or minimize future flood damage.

The 1973 Act amended the NFIP by requiring the OCC, Board, FDIC, OTS, and NCUA to issue regulations governing the lending institutions they supervise (regulated lending institutions or regulated lenders). These agencies' regulations directed lenders to require flood insurance on improved real estate or mobile homes serving as collateral for a loan (security property) if the security property was located, or was to be located, in a SFHA in a participating community. To implement statutory amendments enacted in 1974, the regulations required lenders to notify borrowers that their security property is located in a SFHA and of the availability of Federal disaster assistance with respect to the property in the event of a flood.

Title V of the Riegle Community Development and Regulatory Improvement Act of 1994[2] (CDRI Act),

[1] These statutes are codified at 42 U.S.C. 4001–4129. The Federal Emergency Management Agency (FEMA) administers the NFIP; its regulations implementing the NFIP appear at 44 CFR parts 59–77.

[2] Pub. L. 103–325, tit. V, 108 Stat. 2160, 2255–87 (September 23, 1994).

which is called the National Flood Insurance Reform Act of 1994 (Reform Act), comprehensively revised the Federal flood insurance statutes.[3] The Reform Act is intended to increase compliance with flood insurance requirements and participation in the NFIP in order to provide additional income to the National Flood Insurance Fund and to decrease the financial burden of flooding on the Federal government, taxpayers, and flood victims.[4] The Reform Act requires the OCC, Board, FDIC, OTS, and NCUA to revise their current flood insurance regulations and requires the FCA to promulgate flood insurance regulations for the first time. In order to fulfill these statutory requirements, the six agencies published a joint NPRM in the fall of 1995. *See* 60 FR 53962 (October 18, 1995).[5] The agencies now complete the rulemaking process by issuing this joint final rule.

Four of the agencies—the OCC, Board, FDIC, and OTS—are required by section 303 of the CDRI Act[6] to review their regulations in order to streamline and modify the regulations to improve efficiency, reduce unnecessary costs, and eliminate unwarranted constraints on credit availability. This joint final rule satisfies the regulation review requirement that section 303 applies to these four agencies. The OCC's portion of the joint final rule is part of its Regulation Review Program. Similarly, this joint final rule is part of the programs initiated by the Board, FDIC, OTS, NCUA, and FCA to reduce unnecessary regulatory burden and to simplify and clarify their regulations.

Section 303 also requires the OCC, Board, FDIC, and OTS to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies. This joint final rule also satisfies this portion of section 303. All six of the agencies have reviewed their flood insurance regulations with these purposes in mind. The agencies believe that the joint final rule provides the institutions they regulate with significant flexibility, and minimize the regulatory burden imposed upon regulated lending institutions and loan servicers acting on their behalf, consistent with the requirements of the statute, thus reducing the costs of compliance to those entities and enabling them to operate more efficiently.

II. Overview of Comments Received

The agencies received 138 comment letters on the joint NPRM. The commenters included 12 national banks, two national bank subsidiaries, six state member banks, 15 state nonmember banks, nine savings associations, four Farm Credit organizations, 20 credit unions, 22 financial services holding companies, three State and local government agencies, eight Federal Reserve Banks, 21 trade associations, three flood determination firms, and one insurance agency. In addition, the agencies received comments from five law firms, four mortgage companies, and two consulting services. FEMA also submitted comments.

Thirty-nine commenters expressed general support for the joint NPRM. The majority of these commenters provided specific suggestions for improvement and clarification of the proposal. Twenty-two commenters responded unfavorably to the proposal, characterizing it as overly burdensome or unnecessary. In addition, as discussed later, many commenters sought clarification on specific issues covering a wide spectrum of the proposal's provisions.

The joint final rule is similar to the agencies' proposal in many respects. The agencies, however, have carefully considered the comment letters and have made a number of changes in response to commenters' suggestions and in order to reduce regulatory burden. The topic-by-topic discussion identifies and discusses the significant comments received, describes the provisions of the joint final rule, and highlights changes made by the agencies. Each agency's portion of the joint final rule is substantively consistent, although the format of the regulatory text varies to accommodate the format used at each agency.

III. Description of the Joint Final Rule

A. Need for Supplemental Guidance

The purpose of the Reform Act is to strengthen and enhance the NFIP, and the primary focus of the agencies' joint final rule implementing the Reform Act is to carry out the purpose of the Reform Act. Depending on the location and activities of a regulated lending institution, adequate flood insurance coverage may be important from a safety and soundness perspective as a component of prudent underwriting and as a means of protecting the lender's ongoing interest in its collateral. Accordingly, the preamble to the proposal noted issues that could raise safety and soundness concerns in some circumstances and invited comment on these issues so that the agencies could consider whether to provide informal guidance, separate from the joint final rule, that addresses safe and sound banking concerns presented by regulated lenders' flood insurance programs. In particular, the agencies requested comment on the need for guidance related to purchased loans and institutions with significant exposure to flood hazards.

Commenters sought guidance from the agencies on a wide range of topics including the applicability of the flood insurance rules with respect to condominiums, cooperatives, agricultural buildings, subordinate liens, manufactured homes, home equity lines of credit, fixtures, residential and commercial construction loans, FEMA's appeal process for contested flood hazard determinations, and the standard flood hazard determination form. Eighteen commenters stated that general guidance on safety and soundness issues would be useful, with most preferring informal guidance. Other commenters, primarily credit unions, requested more detailed guidance on compliance with the joint final rule.

A number of commenters stated that additional guidance is not necessary or appropriate, emphasizing that standard financial institution practices are sufficient to protect an institution's interest in its collateral. These commenters stated that the risk profiles of institutions differ, and that the individual institution is in the best position to identify and control major forms of financial risks. A few commenters indicated that each institution should develop and implement risk management procedures to address issues such as geographic lending concentrations and portfolio concentrations.

The joint final rule addresses certain of these concerns, including, for example, agricultural buildings, manufactured homes, the FEMA appeals process, and the standard flood hazard determination form. However, given the number, level of detail, and diversity of subject matter of the requests for additional information, the agencies have concluded that informal staff guidance addressing the more technical compliance issues would be helpful and

[3] A more detailed description of the pertinent provisions of the CDRI Act appears in the preamble to the agencies' joint notice of proposed rulemaking (proposal or NPRM). *See* 60 FR 53962, 53963–65 (October 18, 1995). This preamble refers to the 1968 Act, the 1973 Act, and the Reform Act collectively as the Federal flood insurance statutes.

[4] H.R. Conf. Rep. No. 652, 103d Cong., 2d Sess. 195 (1994) (Conference Report).

[5] In conducting this rulemaking, all six of the agencies have coordinated and consulted with the Federal Financial Institutions Examination Council (FFIEC), as required by certain of the CDRI Act provisions. The heads of five of the six agencies (OCC, Board, FDIC, OTS, and NCUA) comprise the membership of the FFIEC.

[6] 12 U.S.C. 4873.

appropriate. Consequently, the agencies intend to issue informal guidance to address these technical issues subsequent to the promulgation of the joint final rule.

B. Topic-by-Topic Discussion

Authority, Purpose, and Scope

The OCC, Board, FDIC, and OTS proposed in the joint NPRM to expand this section to add detailed statements of authority, purpose, and scope. The FCA proposed language similar to that of the other agencies. The NCUA proposed to replace the question and answer format of its flood insurance regulations with standard regulation text so that its flood insurance regulations are consistent with the other agencies. No comments were received on this section and the agencies adopt it as proposed.

Loan Servicers

The agencies proposed to apply their regulations implementing the escrow, forced placement, and flood hazard determination fee provisions of the Reform Act to regulated lending institutions and to loan servicers acting on behalf of regulated lending institutions. As indicated in the preamble to the proposal, the agencies do not interpret the NFIP to impose obligations on a loan servicer independent from the obligations it imposes on the owner of a loan. The agencies concluded that loan servicers were covered by certain provisions of the Reform Act primarily to ensure that they could perform for the lender the administrative tasks related to the forced placement of flood insurance—including providing the requisite notices to borrowers, arranging for the insurance, and collecting and transmitting insurance premiums—without fear of liability to the borrower for the imposition of unauthorized charges.[7]

The proposal indicated that a regulated lender could fulfill its responsibilities under the NFIP by ensuring that its loan servicing contracts obligated its servicers to perform the duties required by the Federal flood insurance statutes. The agencies also stated that, where there were deficiencies in existing arrangements, lenders should ensure that their loan servicing agreements were revised to provide for the loan servicer to fulfill Federal flood insurance requirements.

The agencies received 21 comments on this issue. Several commenters addressed the relationship between regulated lender and loan servicer with respect to fulfillment of Federal flood insurance requirements and requested detailed additions to the regulatory language to clarify how this relationship is intended to function. One commenter requested that the final rule provide that the lender may rely upon the servicer to fulfill such requirements so long as the lender performs reasonable audits. Another requested that the final rule provide that an originating lender may transfer liability for flood insurance requirements to a servicer, but a third requested clarification that the lender's responsibilities are non-delegable despite its relationship with its servicer. Another commenter requested clarification of the responsibilities of a regulated lender acting as a servicer as opposed to a non-regulated servicer.

In response to these comments, the agencies emphasize that the obligation of a loan servicer to fulfill administrative duties with respect to Federal flood insurance requirements arises from the contractual relationship between the loan servicer and the lender or from other commonly accepted standards for performance of servicing obligations. The lender remains ultimately liable for fulfillment of those responsibilities, and must take adequate steps to ensure that the loan servicer will maintain compliance with the flood insurance requirements. The agencies also wish to emphasize that there is no distinction between a regulated lending institution as servicer and a non-regulated servicer with respect to flood insurance requirements, since either entity acting as servicer will be doing so under the terms of a loan servicing contract. The provisions in the joint final rule with respect to escrow requirements, forced placement, and flood hazard determination fees therefore provide—as in the proposal—that these requirements may be fulfilled either by a regulated lender or a servicer acting on its behalf.

Definitions

The proposal added or revised several definitions, including definitions of the terms *building, designated loan, mobile home,* and *servicer,* and also added several other definitions to streamline the agencies' flood insurance regulations, including definitions of the term *Director, residential improved real estate,* and *special flood hazard area.*

The agencies received 20 comments on these definitions. Ten commenters requested clarification on the definition of *mobile home.* For purposes of the appendix to 44 CFR part 61, which sets forth FEMA's standard flood insurance policy, ''mobile home'' (the term used in the Federal flood insurance statutes) is defined to have the same meaning as ''manufactured home.''[8] The text of the proposal is modified to reflect that the two terms have the same meaning. In order to ensure consistency with the term as used in the Reform Act and avoid conflicting interpretations, the agencies believe it is appropriate to defer to FEMA's interpretations with respect to what is a ''properly secured'' mobile home for flood insurance purposes.

Two commenters requested a definition of the phrase ''making, increasing, extending, or renewing a loan.'' The agencies believe that Congress intended the flood insurance purchase requirements to be applicable at origination, or at any time thereafter during the life of the loan when the institution determines that the security property is located in an area having special flood hazards.[9] The specific issues that arise in connection with this phrase are discussed later in this preamble in ''Loan Purchase as Equivalent to Making a Loan,'' ''Loan Acquisitions Involving Table Funding Arrangements,'' and ''Use of Standard Flood Hazard Determination Form.''

Two commenters suggested revisions of the definition of *residential improved real estate.* These comments are discussed later in this preamble in ''Escrow of Flood Insurance Payments.''

Flood Insurance Requirement

The proposal did not amend substantively the existing regulatory provision that implements the statutory requirement that flood insurance must be purchased for the term of a loan when the security property is located in a SFHA in a community that participates in the NFIP. The proposal also did not amend substantively the existing regulatory provision with respect to the minimum amount of insurance required by statute for such

[7] The agencies also noted that section 102(f) of the 1973 Act as added by the Reform Act, 42 U.S.C. 4012a(f), does not authorize them to seek civil money penalties against loan servicers that are not regulated lending institutions. The statute's failure to impose liability on servicers independent of lenders reinforces the conclusion that a servicer's obligation to comply with NFIP requirements arises from its contractual relationship with a lender.

[8] *See* 44 CFR 59.1 (defining manufactured home), 44 CFR 61.13 and Appendix A to 44 CFR part 61 (FEMA's standard flood insurance policy defining mobile home as meaning manufactured home); 58 FR 62420 (Nov. 26, 1993). FEMA recently amended 44 CFR part 65, which sets forth the procedures to be followed for the review by FEMA of a contested flood hazard determination, to substitute the term ''manufactured home'' for ''mobile home.'' FEMA explained that it made this change because the former term is now the preferred term in the industry. *See* 60 FR 62213 (Dec. 5, 1995).

[9] Conference Report at 197.

property. The Reform Act made no changes to these statutory requirements.

The agencies received 28 comments on this issue. Five commenters requested that the final rule provide that the amount of flood insurance may be limited to the overall value of the property minus the value of the land. When flood insurance is required, the policy must cover the outstanding principal balance of the loan or the maximum amount available under the NFIP, whichever is less. The flood insurance statutes are intended to provide coverage to the improvements. As suggested by the commenters who addressed this point, the joint final rule provides that, in addition to the statutorily prescribed dollar limits, flood insurance coverage under the NFIP is limited to the overall value of the property less than the value of the land.

Five commenters requested that the final rule provide that Federal flood insurance requirements do not apply to loans where a security interest in improved real property is only taken ''out of an abundance of caution.'' Section 102(b)(1) of the 1973 Act, as amended by the Reform Act,[10] provides that a regulated lending institution may not make, increase, extend, or renew any loan secured by improved real property that is located in a special flood hazard area unless the improved real property is covered by the minimum amount of flood insurance required by statute. The requested exception is not available under the 1973 Act.

One commenter inquired whether flood insurance coverage could be purchased for ''developed lots,'' that is, land that secures a loan to improve the property by streets, sewers, and utilities (but no ''above-ground'' improvements such as buildings) so it may then be sold to homebuilders who may construct residential housing on the developed lots. As previously noted in this section, flood insurance generally is available only with respect to a structure or mobile home and not with respect to the land on which the structure or mobile home sits. Flood insurance therefore would not be available under the NFIP for property used to secure a development loan of the type described in this paragraph.

One commenter asked whether the requirement to maintain flood insurance coverage for the term of the loan continues if a regulated lender sells the loan to a non-regulated lender while retaining servicing rights. The commenter wanted to ascertain whether the servicer in such a situation would have the authority to force place insurance and whether the servicer would be subject to criticism upon examination if the non-regulated lender instructed the servicer not to force place.

As noted in the discussion on ''Loan Servicers,'' the agencies believe that the obligation of a loan servicer to fulfill Federal flood insurance requirements arises from the contractual relationship between the loan servicer and the regulated lender or other commonly accepted standards for performance. The duties of a regulated lender with respect to Federal flood insurance requirements for a particular loan cease upon the sale of the loan unless the seller agrees to retain responsibility for such requirements under a loan servicing agreement with the transferee owner. When a loan servicer force places flood insurance, it does so on behalf of the lender in accordance with the loan servicing agreement. If a lender instructs a loan servicer not to force place flood insurance, the responsibility for that instruction, and for any deficiency in compliance, remains with the lender.

One commenter requested that the final rule state that a regulated lender has no duty to change the amount of insurance coverage on a loan unless the loan is increased, extended or renewed. The agencies note in response that a lender may have to increase the amount of coverage on a loan in instances other than the increase, extension, or renewal of a loan, such as when the amount of insurance available under the 1968 Act has been increased and the lender determines that the borrower does not have adequate coverage.

One commenter stated that the proposal did not address the requirements for ''contents coverage'' for loans secured by personal property within a structure located in a SFHA. The agencies agree with the commenter that contents coverage is not required unless, as specified in section 102(b) of the 1973 Act,[11] personal property secures the loan in addition to improved real property. The proposal included language requiring flood insurance for any personal property securing a loan that is also secured by real property. The agencies believe that this language adequately addresses this point.

One commenter requested that the final rule state that a lender may refuse to make a loan in a SFHA when Federal flood insurance is not available, such as in communities that do not participate in the NFIP. The agencies' flood insurance regulations in effect before the effective date of this joint final rule state that the requirement to obtain flood insurance for security property applies only to those areas where flood insurance has been made available under the 1968 Act. The proposal stated that the requirement applies only to a *designated loan,* a term defined to mean a loan secured by a building or mobile home located or to be located in a SFHA where flood insurance is available under the 1968 Act. The effect of these two provisions is the same, namely, that a lender may exercise discretion and decline to make a loan in a SFHA where Federal flood insurance is not available. The agencies therefore believe that the requested change is not necessary.

The same commenter requested that the final rule expressly state that a lender may require flood insurance on any loan, even when not required by the final rule. A requirement for flood insurance on security property that is not subject to the Federal flood insurance statutes is a matter of contract between the lender and borrower. Consistent with the agencies' view that the joint final rule should include only those provisions necessary to implement the flood insurance statutes, the agencies have not included this provision in the joint final rule.

Loan Purchase as Equivalent to Making a Loan

The proposal noted that the agencies' regulations in effect until the effective date of this joint final rule differ as to whether a loan purchase constitutes the ''making'' of a loan that would trigger an obligation to make a flood hazard determination. The OCC and the Board have taken the position that a loan purchase does not trigger such an obligation. The OTS has treated a loan purchase as the equivalent of ''making'' a loan, and the NCUA has taken the position that if flood insurance is required for a Federal credit union (FCU) to make a loan, then flood insurance is necessary for an FCU to purchase a loan. The FDIC has not previously taken a position.

The proposal highlighted the agencies' desire for regulatory uniformity. Accordingly, the OTS proposed to remove loan purchases from its flood insurance regulations; the FDIC proposed to adopt the position of the OCC and the Board; and the NCUA invited comment on whether it should maintain its position.

The agencies received 44 letters on this issue. The overwhelming majority agreed that a loan purchase should not require a flood hazard determination. Three commenters, including FEMA,

[10] *See* 42 U.S.C. 4012a(b)(1).

[11] 42 U.S.C. 4012a(b)(1).

believed that a loan purchase should be considered the ''making'' of a loan.

As noted in the preamble to the proposal, the 1973 Act identifies the events that trigger a lender's obligation to review the adequacy of flood insurance coverage on an affected loan (*e.g.*, the making, increasing, extending, or renewing of a loan). The Reform Act does not include a loan purchase in this list of specified tripwires. As a practical matter, a loan purchaser may always require, as a condition of purchase, that the seller determine whether the property securing the loan is located in a SFHA.

The preamble further noted that, with respect to loans sold in the secondary mortgage market, the inclusion of a loan purchase as a tripwire event may be unnecessary because of the expansion of the scope of the NFIP's coverage with regard to Fannie Mae and Freddie Mac (the largest volume purchasers of residential mortgage loans).[12] Finally, the preamble to the proposal noted that including a loan purchase as a regulatory tripwire could result in the imposition of duplicative and potentially inconsistent requirements on the seller and the purchaser of a resential mortgage loan sold in the secondary market.

For these reasons, and to promote consistent treatment for all regulated lending institutions, the OTS and FDIC are hereby adopting the position of the OCC and the Board that a loan purchase is not an event that triggers the obligation to make a flood hazard determination. While the authority of Farm Credit System institutions is limited with regard to loan purchases, the FCA also concurs with the position of the OCC and the Board on this issue.

The NCUA requested comment on its position that a borrower must obtain adequate flood insurance before an FCU can purchase the borrower's loan if flood insurance coverage would have been required for the FCU to have made the loan initially. Two commenters agreed with the NCUA and 14 commenters suggested that the NCUA adopt the other agencies' position. Ten of the commenters that disagreed with the NCUA stated that the agencies should be consistent on this issue. Seven commenters suggested that the NCUA's position treats loan purchasing as a triggering event and requires credit unions to unnecessarily duplicate the original lenders' flood insurance determinations. Two commenters suggested that credit unions should be able to check the flood status of a loan before purchasing it.

The NCUA agrees that a loan purchase does not trigger a flood hazard determination and that requiring a determination when an FCU purchases a loan could be duplicative. However, the NCUA's regulation governing loan purchases provides additional requirements for FCUs.[13] Section 701.23(b)(1)(i) only permits an FCU to purchase its members' loans if the FCU could grant the loan or if the FCU refinances the loan within 60 days. Accordingly, before an FCU purchases a member's loan to hold in its portfolio, the FCU must determine whether the improved real property securing the loan has adequate flood insurance coverage. This may be accomplished by reviewing the loan documentation or by making a new determination. The FCU avoids these additional requirements when the FCU originates real-estate-secured loans on an ongoing basis and purchases loans to package and sell in the secondary mortgage market.[14]

Finally, the NCUA notes that while the agency's flood insurance regulations, 12 CFR part 760, apply to all Federally-insured credit unions, § 701.23 applies only to FCUs. A Federally-insured State-chartered credit union should follow the loan purchasing guidelines of its state regulator.

Loan Acquisitions Involving Table Funding Arrangements

The agencies invited comment on whether a regulated lender that provides table funding to close a loan originated by a mortgage broker or mobile home dealer should be deemed to be ''making'' or ''purchasing'' the loan for purposes of the flood insurance requirements. In the typical table funding situation, the party providing the funding reviews and approves the credit standing of the borrower and issues a commitment to the broker or dealer to purchase the loan at the time the loan is originated. Frequently, all loan documentation and other statutorily mandated notices are supplied by the party providing the funding, rather than the broker or dealer. The funding party provides the original funding ''at the table'' when the broker or dealer and the borrower close the loan. Concurrent with the loan closing, the funding party acquires the loan from the broker or dealer. While the transaction is, in substance, a loan made by the funding party, it is structured as the purchase of a loan. The preamble to the proposal indicated that the agencies were inclined to treat table funded loans like loans made, rather than purchased, by the funding party.

The preamble to the proposal outlined guidance provided by the regulations of the Department of Housing and Urban Development (HUD) implementing the Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. 2601–2616,[15] and the Financial Accounting Standards Board (FASB)[16] for distinguishing between making and purchasing loans.

The agencies invited comment on: (1) their position that a table funded transaction is more like the making of a loan by the provider of funds than a purchase of a loan in the secondary market; and (2) whether the RESPA or FASB standard is a more appropriate guideline for defining a table funded transaction as either the making or the purchase of a loan.

The agencies received 40 letters on this issue. Twenty commenters agreed with the agencies that a table funded transaction is more like making a loan, eight believed the transaction is more like a loan purchase, and seven expressed some other view. Some commenters addressed only whether the RESPA or FASB standards provided more appropriate guidance. Fourteen commenters supported the RESPA standard while thirteen supported the FASB standard.

The commenters who favored the RESPA standard asserted that RESPA provides a better model for determining the appropriate treatment of table funded transactions because it reflects the realities of the market place and focuses on the structure of the transaction. Some commenters also noted that it would be less confusing and burdensome for lenders, and less likely to result in errors by lenders, to treat the same transaction in a consistent manner for purposes of both RESPA and the Reform Act.

The commenters who supported the FASB standard asserted that it is clearer and more workable. Some stated that the broker or dealer originating the transaction is usually responsible for the

[12] The agencies note that both Fannie Mae and Freddie Mac require their respective sellers and servicers to be in full compliance with the flood insurance statutes. *See* Fannie Mae Announcement No. 95–10 (June 8, 1995), Freddie Mac Bulletin No. 94–18 (December 8, 1994).

[13] 12 CFR 701.23.

[14] 12 CFR 701.23(b)(1)(i).

[15] *See* 24 CFR 3500.2, 3500.5(b)(7).

[16] *See* FASB, Emerging Issues Task Force (EITF) Abstracts, EITF Issue No. 92–10, ''Loan Acquisitions Involving Table Funding Arrangements,'' 1993 (interpreting FASB Statement of Financial Accounting Standards No. 65, ''Accounting for Certain Mortgage Banking Activities'') (FASB Statement No. 65). This EITF table funding interpretation elaborated on guidance that has been superseded. *See* FASB, Statement of Financial Accounting Standards No. 122, ''Accounting for Mortgage Servicing Rights,'' May 1995 (superseding FASB Statement No. 65).

flood hazard determination. If the transaction is not treated as a loan purchase, the acquiring regulated lender would have to perform a duplicative flood hazard determination—and the duplicative costs would have to be absorbed by the lender or borrower.

The joint final rule reflects the agencies' position that, for flood hazard determination purposes, the substance of the table funded transaction should control and that the typical table funded transaction should be considered a loan made, rather than purchased, by the entity that actually supplies the funds. Regulated lenders who provide table funding to close loans originated by a mortgage broker or mobile home dealer will be considered to be ''making'' a loan for purposes of the flood insurance requirements. The agencies believe that this treatment most closely reflects the realities of such transactions, which are purchases only in a technical sense. The presence of a mortgage broker or a mobile home dealer in the transaction should not obscure the fact that the entity supplying the funds is actually primarily responsible for the credit decision and will bear any risk inherent in the loan upon completion of the transaction.

The agencies have also concluded that it is appropriate to use the RESPA standard to define when a table funded loan will be treated as the making of a loan. Under the current RESPA regulations, table funding is defined as a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds. This RESPA definition is used to determine whether a transaction will be treated as a loan or as a secondary market transaction. The funding entity is responsible for meeting the disclosure requirements of RESPA if the transaction is a loan; the funding entity generally would have no responsibilities under RESPA if the transaction is a secondary market transaction. The purpose for which the RESPA standard was developed is therefore similar to the purpose for which the standard would be used in connection with the flood insurance regulations.

The FASB standard referenced in the proposal, on the other hand, was intended to provide guidance to lenders on the proper accounting treatment for mortgage servicing rights and loan origination costs, and focused on factors such as which entity is the first titled owner of the loan, whether the broker is independent of the lender and sells loans to more than one lender, and whether the broker has been indemnified by the lender for the market and credit risks connected with the loan. Based on these criteria, the FASB guidance permitted transactions to be treated as purchased loans even where the lender had a significant level of involvement in the underwriting process.

In order to ensure that lenders are aware of the treatment of table funded transactions, the joint final rule includes a definition of *table funding* that is identical to the current RESPA definition. The joint final rule also states that a lender that acquires a loan from a mortgage broker or other entity through table funding will be considered to be making a loan for the purposes of the joint final rule.

The agencies also note that treating table funded loans as loans made by the funding entity need not result in duplication of flood hazard determinations and borrower notices, a possibility that concerned several commenters. The funding entity may delegate to the broker or dealer originating the transaction the responsibility for fulfilling the flood insurance requirements or may otherwise divide the responsibilities with the broker or dealer, as is currently done with respect to the RESPA requirements.

Applicability of Federal Flood Insurance Requirements to Subsidiaries

In the preamble to the proposal, each of the agencies briefly discussed the applicability of its flood insurance rules to the subsidiaries of the institutions it regulates. The OCC noted that a national bank's operating subsidiary is subject to the rules applicable to the operations of its parent bank as provided under 12 CFR 5.34. Similarly, the Board noted that a state member bank's operating subsidiary is subject to the rules applicable to the operations of its parent bank, and the OTS said that a savings association's operating subsidiary is subject to the rules applicable to its parent thrift. The FDIC stated that its authority to regulate insured nonmember banks extends to activities that such institutions may conduct through a subsidiary. The FCA indicated that a Farm Credit System service corporation does not have the authority to extend credit. The NCUA indicated that a credit union's subsidiary organization, called a credit union service organization (CUSO), is not a ''regulated lending institution'' subject to the Reform Act, but as a practical matter, a CUSO must adhere to the flood insurance requirements. The agencies also indicated that the question of whether the Federal flood insurance statutes apply to a mortgage banking subsidiary of a regulated lending institution is mooted to some extent by the Reform Act's amendment requiring Fannie Mae and Freddie Mac to ensure that flood insurance requirements are met for the loans they purchase.

The OTS also noted in the proposal that its current regulations did not apply to service corporations but that the OTS interpreted the Reform Act's new definition of ''regulated lending institution,'' including the phrase ''similar institution subject to the supervision of a Federal entity for lending regulation,'' to include subsidiaries of thrift institutions that are service corporations. The OTS proposed to apply its flood insurance regulations to service corporations that engage in mortgage lending. The OTS believed that this position was consistent with the Reform Act's statutory language and Congressional intent, and would ensure uniform and consistent treatment for regulated financial institutions.

The FDIC invited comment on its proposed interpretation to require subsidiaries of insured nonmember banks that engage in lending secured by real estate to comply with the flood insurance requirements.

The agencies received eight comment letters on this issue. Seven supported the OTS's and FDIC's positions. One, a thrift trade association, opposed extending flood insurance regulations to service corporations because of the unfair burden that would be placed on bank and thrift subsidiaries relative to mortgage bankers. The agencies received one comment letter that supported the NCUA's position.

Based on the commenters' responses and the desire for regulatory consistency, the OTS's portion of the joint final rule applies to service corporations. The OTS believes that the purpose of the Federal flood insurance statutes is best served by treating loans made by service corporations in the same way as loans made elsewhere in the corporate structure by the thrift institution or its operating subsidiaries. The FDIC's portion of the joint final rule makes subsidiaries of insured nonmember banks subject to Federal flood insurance requirements by defining the term ''bank'' to include a subsidiary of such institutions. The positions of the other agencies, as reflected in their statements in the preamble to the proposal, are unchanged.

Exemptions

The proposal retained the exemption from the basic flood insurance requirement for State-owned property that is self-insured in a manner

satisfactory to the Director of FEMA, and added the Reform Act's new exemption for loans with an original principal balance of $5,000 or less and a repayment term of one year or less. The agencies received 19 comment letters on this issue. Fifteen commenters requested expansion of the statutory exemption for loans in the amount of $5,000 or less with a term of one year or less. Because the exemption has been established by statute (*see* 42 U.S.C. 4012a(c)(2)), it may only be expanded by a legislative amendment. The joint final rule therefore adopts the language as proposed.

Escrow of Flood Insurance Payments

Definition of residential improved real estate. As required by the Reform Act, the proposal stated that a regulated lender must require the escrow of flood insurance premiums for loans secured by *residential improved real estate* if the lender requires the escrow of other funds to cover other charges associated with the loan, such as taxes, premiums for hazard or fire insurance, or any other fees. The proposal also cautioned that, depending on the type of loan, the escrow account for flood insurance premiums may be subject to section 10 of RESPA, 12 U.S.C. 2609,[17] which generally limits the amount that may be maintained in escrow accounts for consumer mortgage loans, and requires notices containing escrow account statements for those accounts.

There are differences between the scope of the Reform Act's coverage and the scope of RESPA's coverage that raise a question about how the two laws should be applied together. The Reform Act's escrow provision applies to loans secured by ''residential improved real estate,'' a term defined in the Reform Act as improved real estate for which the improvement is a residential building.[18] This definition does not distinguish between mortgage loans secured by one to four family residential buildings and commercial loans secured by residential buildings. Under the language of the proposal, therefore, the Reform Act's escrow provision applied to both home mortgage loans and commercial loans—including, for example, mortgages on apartment buildings or construction loans secured by residential buildings—but, only if the lender requires the escrow of other charges for those loans.

RESPA, on the other hand, applies to a ''federally related mortgage loan,'' which is defined as a loan secured by a first or subordinate lien on residential real property designed principally for the occupancy of from one to four families.[19] Further, by regulation HUD has determined that RESPA does not cover construction financing, loans primarily for business, commercial, or agricultural purposes, loans secured by 25 acres or more of real estate, whether residential or commercial, and loans on vacant or undeveloped property not developed within two years.[20] Similarly, the limits on amounts escrowed and the escrow account statement requirements prescribed by RESPA section 10, which is the only RESPA section that the Reform Act makes applicable to flood insurance premiums, apply only to consumer mortgage loans.

In the proposal, the agencies resolved the differences between the scope of coverage of the two statutes by applying RESPA section 10 only to flood insurance escrow accounts for loans that are already subject to RESPA generally, *i.e.*, escrows for consumer mortgage loans. The agencies took the position that (1) the escrow of flood insurance premiums is required whenever the lender escrows other charges associated with the loan, but (2) the detailed requirements of RESPA section 10 do not apply unless the loan itself is subject to RESPA.

The agencies received 20 comments on the scope of the escrow requirement. Five commenters generally agreed with the proposal, while 15 requested additional clarification on specific matters. Five commenters said that the term *residential improved real estate* as defined in the proposal could be interpreted to include loans on multi-family properties, which are mortgage loans secured by five or more family residential units typically processed as commercial loans made for a business purpose. These commenters recommended that the agencies limit the Reform Act's escrow requirement only to those loans that are subject to RESPA. Some commenters requested that the final rule distinguish between mortgage loans secured by one to four family residential units and mortgage loans secured by multi-family units, and asked that the definition be modified so that it applies only to the former type of mortgage loans. They stated that if this change were made, lenders would not have to escrow for flood insurance on mortgage loans secured by five or more family units, thereby easing their administrative burdens. They also pointed out that this would take advantage of a well-understood approach to distinguishing between loans on residential and other property, and thereby minimize confusion and increase compliance.

Industry commenters also pointed out that loans on commercial property are processed quite differently from consumer loans and often are subject to extensive negotiation of terms. Escrows on such loans may reflect required property maintenance expenditures or compensating balances as a pricing term rather than the types of payments covered by escrows on consumer mortgage loans. On the other hand, FEMA, although observing that the Reform Act neither required nor authorized the agencies to require escrows on commercial properties, recommended that the agencies impose a similar escrow requirement on commercial property loans as well.

The escrow provisions of the Reform Act are designed to improve compliance with flood insurance requirements by ensuring that homeowners located in special flood hazard areas obtain and maintain flood insurance for the life of the loan. The Conference Report stated that a major reason for the lack of compliance with the NFIP is that many homeowners stop paying premiums on their flood insurance policies.[21] However, the Reform Act itself simply does not restrict the flood insurance escrow requirement to consumer mortgage loans. The determinative factor in the coverage of the escrow requirement is not the purpose of the loan, but the purpose of the building—whether it is primarily used for residential purposes.

Section 10 of RESPA, the only RESPA provision that the Reform Act makes applicable to flood insurance escrow accounts, limits the amounts that lenders and servicers may legally require borrowers to deposit in escrow accounts.[22] In 1994, HUD amended its RESPA regulations[23] to interpret section 10 of RESPA by establishing a nationwide standard escrow accounting method known as aggregate accounting and giving lenders and servicers specific guidance on the requirements of section 10. The final rule required lenders and servicers to use the aggregate accounting method for escrow accounts involving

[17] The regulations of HUD implementing section 10 appear at 24 CFR 3500.17 (1995); *see also* 60 FR 8812 (Feb. 15, 1995), 60 FR 24734 (May 9, 1995), 61 FR 13232 (Mar. 26, 1996) and 61 FR 29238 (June 7, 1996) (revising § 3500.17).

[18] 42 U.S.C. 4012a(d)(4). The proposal defined the term as real estate upon which a home or other residential building is located or to be located.

[19] 19 12 U.S.C. 2602(1)(A).

[20] *See* 24 CFR 3500.5(b).

[21] Conference Report at 198.

[22] 12 U.S.C. 2609.

[23] HUD, Final Rule on Escrow Accounting Procedures, 59 FR 53890 (Oct. 26, 1994) (adding 24 CFR 3500.17).

consumer mortgage loans, instead of the method known as single-item analysis accounting, and provided a phase-in period for existing escrow accounts to convert to the aggregate accounting method.[24] This change was intended to reduce the cost of home ownership, by ensuring that funds would not be held in escrow accounts in excess of the amounts necessary to protect lenders' interests in preserving loan collateral.[25] It appears that Congress intended to apply the same section 10 limits to the new flood insurance escrow accounts required under the Reform Act. Because of the differences between the scope of coverage of the Reform Act and RESPA, however, the agencies do not believe that the Reform Act is intended to impose the particular requirements of section 10 on loans that are not subject to RESPA generally, for example, commercial loans secured by residential buildings. There is nothing in the legislative history of the Reform Act suggesting that Congress meant to extend the scope of section 10 of RESPA in this way through the enactment of the Reform Act, and absent specific direction from Congress, the agencies did not believe that they had the authority to expand RESPA's section 10 coverage to loans that are not otherwise subject to RESPA.

In addition, RESPA only applies to mobile home loans if they are also secured by real estate, whereas the Reform Act applies to mobile home loans whether or not secured by real estate. RESPA also exempts all loans secured by 25 acres or more of real estate, whether residential, commercial, or agricultural, whereas the Reform Act applies to all such loans if secured by structures primarily used for residential purposes. While RESPA and the Reform Act cover refinancings,[26] the Reform Act also covers increases, extensions, and renewals.

In the joint final rule, the text of the agencies' definition of *residential improved real estate* is the same as was proposed. It primarily covers loans that are otherwise subject to RESPA. But, because the Reform Act defines ''residential improved real estate'' as ''improved real estate for which the improvement is a residential building,'' multi-family properties containing five or more residential units are covered under the Reform Act's escrow provisions, as are single family dwellings (including mobile homes) and two to four family dwellings. A construction loan, loan secured by 25 acres or more of real estate, or commercial loan is subject to the escrow requirements if the loan is secured by improved real estate primarily used for residential purposes and an escrow account is required in connection with the loan for taxes, insurance premiums, fees, and other charges. Finally, except for escrows on consumer mortgage loans, the escrow accounts established for these loans need not comply with the requirements of section 10 of RESPA. The agencies have also made minor conforming changes to the text of the escrow provision.

Types of escrow accounts covered. Six commenters asked for clarification of what constitutes a ''required'' escrow. The commenters were divided on whether a ''voluntary'' escrow account (where the borrower requests the lender to establish an escrow account) should trigger a flood insurance escrow requirement. The Reform Act mandates a flood insurance escrow only when a regulated lending institution requires an escrow account for taxes, insurance, fees, or other charges. Although exclusion of voluntary escrows could lead to the possibility of evasion and difficulties in examining for compliance, the agencies do not believe that the Reform Act mandates escrow of flood insurance premiums in connection with escrow accounts specifically requested by the borrower. However, where a lender is escrowing for hazard insurance premiums or taxes without also escrowing for flood insurance premiums, the lender will have the burden of demonstrating that the escrow arrangement is truly voluntary.

In determining whether an escrow account arrangement is voluntary, the agencies believe it is appropriate to look to the loan policies of the regulated lender and the contractual agreement underlying the loan. If the loan documentation permits the lender to require an escrow account, and the lender's loan policies normally would require an escrow account for a loan with particular characteristics, an escrow account in connection with such a loan generally would not be considered to be voluntary. An escrow arrangement generally would be viewed as voluntary, however, if the policies of the lender do not require the establishment of an escrow account in connection with the particular type of loan, even though the loan documentation may permit a lender to require the establishment of an escrow account.

Additionally not all accounts established in connection with a loan secured by residential improved real estate are considered to be escrow accounts that would trigger the requirement for the escrow of flood insurance premiums. For example, accounts established in connection with commercial loans for such items as interest or maintenance reserves or compensating balances are not considered to be escrow accounts for the purposes of this provision. As a general matter, accounts established in connection with the underlying agreement between the buyer and seller or that relate to the commercial venture itself, rather than to the protection of the property, would not be considered to trigger the escrow requirements for flood insurance premiums.

Several commenters asked if the requirement to escrow flood insurance premiums would be triggered only if other escrows were required on the particular loan in question, rather than if the institution generally required escrows on other loans of similar type. The agencies agree that the final rule should be applied on a loan-by-loan basis within similar types of loans.

Several commenters asked whether voluntary payments for credit life insurance would trigger a flood insurance escrow. The agencies note, as did some of these commenters, that HUD takes the position that voluntary payments for credit life insurance do not constitute escrows for purposes of RESPA,[27] and, accordingly, believe that payments under credit life insurance and similar types of contracts should not trigger the escrow of flood insurance premiums. Escrows for hazard insurance such as fire, storm, wind, or earthquake are the types of insurance that trigger the requirement to escrow flood insurance premiums if such insurance is required on the loan.

Various commenters opposed flood insurance escrows in general or thought that insurance companies or municipalities would be the logical entities to enforce the purchase and maintenance of flood insurance. However, the agencies note that the requirement is mandated by the Reform Act. Other commenters pointed out that their institutions lack the capability for escrows, either in general or with respect to mobile homes. Both the statute and this joint final rule specify that escrow of flood hazard insurance payments is required only when other payments also are escrowed.

[24] 59 FR at 53890. The rule also established formats and procedures for initial and annual escrow account statements.

[25] Id. at 53890–91.

[26] See Conference Report at 197.

[27] See 60 FR 24733 (May 9, 1995) (revising 24 CFR 3500.17).

Forced Placement

The proposal set forth the requirement imposed by the Reform Act on a regulated lender or a servicer acting on its behalf to purchase or ''force place'' flood insurance for the borrower if the lender or the servicer determines that adequate coverage is lacking. The agencies received 31 comments on this issue.

Four commenters asked if a loan could be made without flood insurance in place provided the lender gave notice to the borrower at closing that flood insurance must be obtained by the borrower within 45 days from the date of closing and that the lender would force place insurance if the borrower had not complied by the end of that period. Section 102(e)(2) of the 1973 Act, as amended, 42 U.S.C. 4012a(e)(2), provides for forced placement of flood insurance 45 days after the borrower is notified of deficient flood insurance coverage. The agencies do not interpret this provision of the Reform Act as granting a borrower 45 days from loan closing to arrange for flood insurance on the security property.

The agencies believe that the addition of the forced placement authority does not lessen the need for flood insurance to be in place at the time a loan is made. Section 102(e) of the 1973 Act provides that the agencies must require a regulated lending institution not to make, increase, extend, or renew any loan secured by improved real property located in a SFHA unless the security property is covered by the minimum amount of flood insurance required by the statute. The agencies interpret this provision to mean that the flood insurance regulations must require that such insurance be in place at the time a lender makes a loan that is secured by improved real property located in a SFHA.

The agencies believe that the forced placement provision of the Reform Act is designed to complement the other statutory tripwires for ensuring that security property located in a SFHA is adequately covered by flood insurance. As a practical matter, forced placement should not be necessary at the time of making, increasing, extending, or renewing a loan, when the lender is obligated to require that flood insurance be in place. Rather, forced placement authority is designed to be used if, over the term of the loan, the lender or its servicer determines that flood insurance coverage on the security property is deficient under section 102(e) of the 1973 Act.

To further emphasize this point, the agencies are removing the phrase ''at the time of origination or'' from the final version of the forced placement regulation. The agencies realize that this phrase tracks the statutory language set forth in section 102(e)(1) of the 1973 Act. The agencies believe, however, that the removal of this phrase will not substantively alter the requirements of the rule since this joint final rule still provides, in accordance with the statute, that a lender or servicer acting on its behalf is under a duty during the term of a designated loan to force place insurance if the lender or servicer acting on the lender's behalf determines that the security property is not adequately insured. The removal of this phrase clarifies (1) that flood insurance coverage must be in effect at the time of closing of a designated loan, and (2) the duties of a lender or its servicer with respect to forced placement of flood insurance.

One commenter requested clarification as to the precise amount of flood insurance a lender or servicer acting on its behalf is required to force place. Section 102(b)(1) of the 1973 Act, as amended, 42 U.S.C. 4012a(b)(1), states that security property located in a SFHA must be covered for the term of the loan by flood insurance in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage available under Federal flood insurance statutes, whichever is less. A regulated lender must therefore initiate procedures to force place flood insurance whenever the amount of coverage in place is not equal to the lesser of the outstanding principal balance of the loan or the maximum stipulated by statute for the particular category of property securing the loan. The amount that must be force placed is equal to the difference between the present amount of coverage and the lesser of the outstanding principal balance or the maximum coverage limit.

One commenter suggested that forced placement should be at the lender's discretion while another commented that the final rule should state that lenders have both the legal authority and obligation to force place flood insurance. The agencies wish to make it plain that under section 102(e) of the 1973 Act lenders are both authorized and obligated to force place flood insurance if necessary. The joint final rule therefore provides that a lender, or servicer acting on the lender's behalf, upon discovering that security property is not covered by an adequate amount of flood insurance, must, after providing notice and an opportunity for the borrower to obtain the necessary amount of flood insurance, purchase flood insurance in the appropriate amount on the borrower's behalf.

Portfolio Review

The preamble to the proposal indicated that neither the Reform Act nor the proposed rule required a regulated lending institution or servicer acting on the lender's behalf to conduct a review of all loans in portfolio as of September 23, 1994, that is, a retroactive portfolio review. The Reform Act does not revise the list of events that trigger a determination (the making, increasing, renewing, or extension of a loan, sometimes referred to as the statutory tripwires). The proposal also indicated that a requirement for retroactive portfolio review would impose a costly and unnecessary burden on regulated lending institutions.

Similarly, the agencies did not propose to require a regulated lending institution or servicer acting on its behalf to conduct portfolio reviews on a prospective basis. The preamble noted that the 1968 and 1973 Acts, as amended by the Reform Act, do not prescribe portfolio review as the means that a lender or servicer acting on its behalf must use to determine whether security property is adequately covered by flood insurance. The flood statutes do not require that determinations be made at any particular time, other than in connection with making, increasing, extending, or renewing a loan. Nonetheless, the preamble indicated that a regulated lending institution and servicer acting on its behalf should develop policies and procedures to ensure that, when a determination has been made that property securing a loan is located in a SFHA, they satisfy the requirements of the Reform Act's forced placement provision.

The proposal also noted that it might be appropriate as a matter of safety and soundness for the agencies to ensure that institutions that are significantly exposed to the risks for which flood insurance is designed to compensate determine the adequacy of flood insurance coverage by (1) periodic reviews, or (2) reviews triggered by remapping of areas represented in a regulated lending institution's loan portfolio.

The agencies invited comment on the advisability of issuing guidance in this area and on how the guidance should differentiate among regulated lending institutions based on their levels of exposure to flood risk. In particular, the agencies invited comment on the methods that regulated lending institutions already use or are considering for determining the adequacy of flood insurance coverage;

the cost (or other burden) associated with portfolio reviews; and on whether the additional loans for which flood insurance would be required as a result of portfolio reviews would be significant in relation to a regulated lending institution's or its servicer's portfolio.

The agencies received 76 comment letters on this issue, the most letters received on one topic. Forty-four commenters agreed with the agencies' view that the Reform Act does not require retroactive or prospective portfolio review. The same number agreed with the agencies' view that the final rule should not impose a requirement for retroactive or prospective portfolio reviews. Eleven commenters urged the agencies not to issue additional guidance as a safety and soundness matter for institutions that are significantly exposed to the risks for which flood insurance is designed to compensate. However, fourteen commenters recommended that the agencies issue informal guidance addressing, for example, when an institution is ''significantly exposed.''

Twenty commenters stated that the decision whether to engage in portfolio review should be left to the lender. Six recommended that the decision should be determined as a result of examinations, and not dictated in advance by regulations or agency guidance. Some of these commenters stated that the agencies should impose a portfolio review burden only on those individual institutions found in examinations to have inadequate systems in place. Others recommended that safety and soundness issues with respect to the adequacy of flood insurance should be handled on a case-by-case basis through the examination process.

An issue that generated significant comment is whether the Reform Act's forced placement provision implicitly imposes on lenders an affirmative obligation to monitor loans for FEMA map changes for the life of the loan. Ten commenters requested the agencies to address this uncertainty in the final rule.

Nine commenters questioned whether the agencies' position on portfolio review is consistent with the forced placement language of the Reform Act. These commenters stated that the forced placement provision appears to require some action on the lender's part in response to remappings, as a lender will not know whether to force place flood insurance unless it is apprised of changes in the flood zone status of the property. These commenters indicated that the preamble's statement that prospective portfolio review is not required implies that a lender is not required to monitor for map changes subsequent to origination. Another commenter also pointed out that in order to comply with the forced placement provision, a lender may be obliged to conduct a retroactive portfolio review to determine whether it is required to force place insurance on any loans in its portfolio.

Fourteen commenters, however, stated that prospective monitoring is not required because the Reform Act did not group map changes with the statutory tripwires listed in the basic purchase provision of the Reform Act. In their view, a lender does not have a duty to track for map changes. Seven commenters recommended that the final rule explicitly state that there is no duty to track for map changes or that ongoing monitoring is not required. Others pointed out that a requirement to make flood determinations upon remapping alone, without an intervening tripwire event, would impose costly and unnecessary burdens on lenders.

One commenter urged that the final rule provide that the lender's flood determination obligation after loan origination is limited only to the tripwire events, unless the lender, for its own portfolio risk management reasons, wishes to adopt a different approach. Fourteen commenters suggested that life of loan monitoring is one less expensive method lenders could use, pointing out that the cost for ongoing tracking of loans for flood map changes would be lower than the cost of performing periodic reviews or entire portfolio reviews triggered by remappings. Five commenters stated that the additional loans for which flood insurance would be required as a result of portfolio reviews would be insignificant in relation to the lender's or its servicer's portfolio.

The agencies reiterate their view that the Reform Act does not require lenders to engage in retroactive or prospective portfolio reviews or any other specific method for carrying out their responsibilities under the Federal flood insurance statutes. The Reform Act clearly requires lenders to check the status of security property for loans when triggered by the statutory tripwires. The Reform Act did not add remappings to the list of statutory tripwires. The Reform Act does not require lenders to monitor for map changes, and the agencies will not impose such a requirement by regulation. The joint final rule does not require that determinations be made at any time other than when a loan is made, increased, extended, or renewed. If, however, at any time during the life of the loan, the lender, or servicer acting on the lender's behalf, determines that required flood insurance is lacking, the Reform Act requires the lender, or servicer acting on the lender's behalf, to initiate forced placement procedures. A lender, or servicer acting on the lender's behalf, continues to be responsible for ensuring that where flood insurance was required at origination, the borrower renews the flood insurance policy and continues to renew it for as long as flood insurance is required for the security property. If a borrower allows a policy to lapse when insurance is required, the lender, or servicer acting on its behalf, is required to commence forced placement procedures.[28]

The preamble to the proposal stated that depending on the location and activities of a lender, adequate flood insurance coverage may be important from a safety and soundness perspective as a component of prudent underwriting and as a means of protecting the lender's ongoing interest in its collateral. The agencies believe that each lender is in the best position to tailor its flood insurance policies and procedures to suit its business. Lenders should evaluate and, when necessary, modify their flood insurance programs to comport with both the requirements of Federal flood insurance statutes and regulations and principles of safe and sound banking. The agencies believe that more experience should be gained before a decision is made that further guidance is necessary for institutions in areas that have significant exposure to flood hazards. The agencies caution, however, that an institution with a lending area that includes communities that are subject to significant flood hazards, but that do not participate in the NFIP, presents special problems that may not be adequately addressed by the procedures generally used to limit flood risks, such as monitoring of remappings and other procedures.

Penalties

The proposal noted that the penalty provisions of the Reform Act are self-executing and do not require the agencies to develop regulations to implement them. Thus, the agencies did not propose regulations on the penalty provisions. The agencies received six comment letters on this issue. Two recommended that the final rule set out the statutory provisions contained in

[28] The insurance provider routinely notifies the lender, or servicer acting on behalf of the lender, along with the borrower when the insurance contract is due for renewal. The insurance provider also routinely notifies the lender or its servicer as well as the borrower if the insurance provider has not received the policy renewal.

section 102(f) and (g) of the 1973 Act, as amended by the Reform Act, 42 U.S.C. 4012a(f) and (g). Two others requested that the final rule provide guidance on how the agencies intend to implement the broad enforcement authority given to them to take remedial action under section 102(g) of the 1973 Act. One asked the agencies to provide guidance on how the phrase ''pattern or practice'' of noncompliance will be construed, expressing the concern that interpretations should be uniform and not left completely to the discretion of individual examiners. The agencies have determined not to repeat the provisions of the statute in the joint final rule.

One commenter suggested that the final rule refer to the procedural rules that apply to such enforcement actions. The uniform rules of practice and procedure for agency administrative enforcement actions developed by the OCC, Board, FDIC, OTS, and NCUA (Uniform Rules) apply to such actions. Those rules were amended recently to apply the Uniform Rules to the civil money penalty provisions and the remedial actions described in section 102(f) and (g) of the 1973 Act.[29]

Determination Fees

General. The proposed rule included a provision that set forth the authorization conferred by the Reform Act on a lender, or servicer acting on the lender's behalf, to charge a reasonable fee for the costs of making a flood hazard determination under specified circumstances: if the borrower initiates the transaction (making, increasing, extending, or renewing a loan) that triggers a flood hazard determination; if the determination reflects FEMA's revision of flood maps; or if the determination results in the purchase of flood insurance by the lender, or servicer acting on behalf of the lender, under the forced placement provision.

The agencies received 43 comment letters on this issue. Fifteen commenters requested that the final rule clarify that the authority to charge a reasonable fee for the costs of making a flood hazard determination covers a ''life-of-loan'' charge to the borrower that would pay for monitoring of the flood hazard status of the security property for the term of the loan. The agencies believe that the statutory authority to charge a borrower a reasonable fee for a flood hazard determination does extend to a fee for life-of-loan monitoring by either the lender, or servicer acting on behalf of the lender, or by a third party, such as a flood hazard determination company.

While the Reform Act specifies the circumstances that may give rise to the charging of a determination fee, the Act does not expressly provide what may be included in the determination fee nor does the joint final rule adopt a rigid definition. However, the agencies agree that a determination fee may include, among other things, reasonable fees for the costs of an initial flood hazard determination, as well as reasonable fees for a lender, servicer, or third party to monitor the flood hazard status of a security property during the life of a loan for purposes of making determinations on an ongoing basis. Consequently, the joint final rule has been clarified to provide that a determination fee may include, but is not limited to, a life-of-loan monitoring fee. Because the authority to charge a life-of-loan monitoring fee is based on the authority to charge a determination fee, the monitoring fee may be charged only if one of the specified events in the statute occurs.

A commenter asked whether the authority to charge a reasonable determination fee extended to a situation where there has been a remapping, but the security property was found not to be in a SFHA. Section 102(h) of the 1973 Act, 42 U.S.C. 4012a(h), does not distinguish between positive and negative flood hazard determinations in its authorization to charge a reasonable fee for that service in the event of a remapping. Consequently, the agencies believe that a lender, or servicer acting on the lender's behalf, may charge a fee in either situation.

One commenter inquired whether authority to charge determination fees extended only to determinations by third parties. Section 102(h) of the 1973 Act does not distinguish between determinations done in-house by a lender or servicer acting on its behalf and those performed by another entity. The agencies believe that a lender, or servicer acting on its behalf, may charge a determination fee if either of the entities performs this service itself or if the lender or its servicer arranges to have a third party perform the determination.

One commenter requested that the final rule provide that a lender may include out of pocket costs, internal costs, and profit as part of a reasonable flood hazard determination fee. Another suggested that a reasonable fee should cover the costs of notification, obtaining flood insurance, and adding flood insurance premiums to the loan balance. The agencies decline, however, to list all of the components of a reasonable flood hazard determination fee (which may include a life-of-loan monitoring fee) in the joint final rule because that determination may vary depending upon circumstances and is best determined on a case-by-case basis by the regulated lending institution.

Truth in Lending Act Issues. Seven commenters raised issues concerning the interaction between the rules concerning flood insurance and rules under the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, particularly with respect to the treatment of determination fees charged at consummation that include life-of-loan coverage and fees charged subsequent to closing.

Some commenters argued that Regulation Z [30] should not require the portion of a life-of-loan monitoring fee that is not related to the initial determination to be included as part of the finance charge. One commenter stated that, in its experience, the addition of a portion of the life-of-loan monitoring fee to the finance charge did not have a significant impact on the finance charge disclosed, although the costs involved in breaking down charges for the purposes of Regulation Z impose a burden on lenders.

The official staff commentary to Regulation Z (12 CFR part 226 (Supplement I)) explains the proper treatment of life-of-loan fees. The commentary states that fees for services that will be performed periodically during the loan term, including fees for determinations as to whether security property is in a SFHA, may not be excluded from the finance charge, regardless of when the fee is charged. The commentary further indicates that any portion of a fee that does not relate to the initial decision to grant credit must be included in the finance charge.[31] If creditors are uncertain about what portion of a fee is related to the initial decision to grant credit, the entire fee may be treated as a finance charge. Further consideration of this issue would be beyond the scope of this rulemaking.

Several commenters indicated that determination fees assessed after consummation, such as fees for a new determination following a remapping, should not be included as part of the finance charge disclosures under Regulation Z. These commenters argued

[29] *See* 61 FR 28021 (June 4, 1996) and 61 FR 20330–20356 (May 6, 1996). The FCA expects to make similar amendments to its rules of practice. *See* 12 CFR part 662.

[30] The Board's Regulation Z, 12 CFR part 226, implements the Truth in Lending Act.

[31] *See* 12 CFR part 226, Supplement I—Official Staff Interpretations, 12 CFR § 226.4, comment 4(c)(7)-3 (1996).

that whether or not a new determination will be necessary and a fee imposed during the loan term is unknown at the time disclosure is provided. Regulation Z and the commentary state that, generally, if a disclosure provided at or before consummation becomes inaccurate because of a subsequent event, the inaccuracy does not result in a violation. Accordingly, no additional clarification is needed.

Notice Requirements

Borrower. The proposed rule closely tracked the specific notice requirements of section 1364 of the 1968 Act, as amended by the Reform Act, 42 U.S.C. 4104a. Moreover, like the statute, the proposal contained a provision authorizing regulated lending institutions to use an alternate form of notice in certain situations. The alternate notice provision allows the lender to rely on assurances from a seller or lessor that the seller or lessor has provided the requisite notice to the purchaser or lessee of the property who is the ultimate recipient, or borrower, of the lender's funds. The need for this alternate form of notice would arise, for example, in a situation where the lender is providing financing through a developer for the purchase of condominium units by multiple borrowers. The lender may not deal directly with the individual condominium unit purchaser and, in such a case, need not provide notice to each purchaser but may instead rely on the developer/seller's assurances that the developer/seller has given the necessary notice. The same may be true for a cooperative conversion, in which case the sponsor of the conversion may be providing the required notice to the purchasers of the cooperative shares. A purchaser of shares in a cooperative may be considered to be a ''lessee'' rather than a purchaser with respect to the underlying real property. For the reasons explained later, the agencies are adopting the notice requirements provision essentially as it was proposed with minor revisions to clarify the text.

Twenty-two commenters expressed broad support for the continued use of the term ''borrower'' in the notice requirement rather than the phrase ''purchaser or lessee'' used in the statute. The joint final rule retains the term ''borrower,'' except that the alternate notice provision has been revised to clarify that the recipient of the notice to the borrower in cases where the alternate method applies will be the purchaser or lessee of the property.

Twenty commenters, citing increasingly compressed time frames for loan approval and closing in certain circumstances, requested specific guidance on what is meant by the ''reasonable time'' standard for notice delivery established by section 1364 of the 1968 Act, and followed by the agencies in the proposed rule. Other commenters noted that the ''Use of Prescribed Form of Notice'' provision of the proposed rule appeared to establish a conflicting standard of reasonable time—ten days—for notice purposes. These commenters asked which standard controlled. The agencies believe that the statutory standard of providing written notification of special flood hazards within a reasonable period before completion of the transaction offers regulated lending institutions sufficient flexibility to meet the statutory goal of providing adequate notice to borrowers and servicers, while accommodating the need in appropriate circumstances for an abbreviated notice period.

What constitutes ''reasonable'' notice will necessarily vary according to the circumstances of particular transactions. Regulated lending institutions should bear in mind, however, that a borrower should receive notice timely enough to ensure that (1) The borrower has the opportunity to become aware of the borrower's responsibilities under the NFIP; and (2) where applicable, the borrower can purchase flood insurance before completion of the loan transaction. In light of these considerations, the joint final rule does not establish a fixed time period during which a lender provides notice to the borrower. To avoid any confusion regarding application of the ''reasonableness'' standard to notice delivery, the proposed rule authorizing use of the sample form of notice provided in appendix A of the rule has been revised to provide that delivery of notice based on the sample form of notice must take place within a reasonable time before the completion of the transaction. The agencies generally continue to regard ten days as a ''reasonable'' time interval.

Two commenters also raised questions regarding the alternate method of notice provision in the proposed rule. One commenter questioned whether the seller or lessor of the property—as opposed to the lender—is supposed to make the determination regarding the flood status of a security property pursuant to this provision. Another commenter questioned whether the seller or lessor must use the sample form of notice set forth in appendix A to the final rule.

In response, the agencies note that this section of the joint final rule does not shift the burden of determining flood status from the lender to the seller or lessor. Rather, it implements the provision of section 1364(a)(1) of the 1968 Act that permits borrower notice delivered by a seller or lessor to substitute for lender notice so long as the lender receives satisfactory assurances that the notice has been delivered to the borrower. The prescribed contents of the notice do not change when the seller or lessor provides notice to the borrower. Before relying on the alternate form of notice, a lender must have a written assurance that the notice provided by the seller or lessor contained all the elements required by section 1364 of the 1968 Act. The alternate notice provision in the joint final rule is not intended to set a lower notification standard. The seller or lessor notice is subject to the same content requirement as notice by the lender, but a seller or lessor need not use the sample form of notice provided in appendix A to the final rule in order for a lender to rely on the notice.

The agencies received three comments concerning the effect of the proposed notice provisions on lenders that finance the purchase of mobile homes. These commenters noted that, in some mobile home lending transactions, the lender may not know where the mobile home is to be located until just prior to the time of loan closing. In other so-called ''home only'' transactions, the purchaser of the mobile home buys and finances the home separately from the land on which it ultimately will be located. These commenters asserted that they would be unable to comply with the notice requirements until they learn where the mobile home will be located and can thus determine whether the mobile home will be located in a SFHA.

Consistent with the previous discussion in this section of the reasonable notice standard, the agencies believe that the notice requirements of the 1968 Act, as amended, can be met by lenders in mobile home loan transactions if notice is provided to the borrower as soon as practicable after determination that the mobile home is or will be located in a SFHA and before completion of the loan transaction. Particularly in those circumstances where time constraints can be anticipated, regulated lenders should use their best efforts to provide adequate notification of flood hazards to borrowers at the earliest practicable time.

Moreover, the agencies will not apply the borrower notice requirements to those ''home only'' mobile home transactions that close before the permanent location for the mobile home

is known. Clearly, a lender cannot determine whether flood insurance is required before the location of the mobile home has been fixed. When the lender learns the location of the mobile home, the lender must determine whether the mobile home is in a SFHA, notify the borrower and require the purchase of any required flood insurance. The agencies recommend that lenders consider notifying borrowers in ''home only'' mobile home transactions, at the time the loan closes, that they will be required to have and pay for flood insurance if the mobile home they purchase is eventually located in a SFHA in a participating community. The joint final rule does not require this type of notice because the statute does not require it. The agencies' recommendation reflects their view that it would be prudent practice for lenders to avoid imposing unanticipated obligations and costs on borrowers if and when flood insurance becomes necessary.

Servicer. The Reform Act added loan servicers to the entities that must be notified of special flood hazards, and the proposal requested comment on the appropriate timing of notice to the servicer. Thirty commenters felt that notification to the servicer in advance of the closing would not be possible or would serve no purpose. Commenters also pointed out that transfer to a servicer can take up to four months and that in many cases the servicer's identity will not be known until well after the closing. A number of alternative schedules were suggested, including a requirement that the notice of special flood hazards be transmitted to the servicer along with the other data on hazard insurance and taxes required to service a loan with an escrow, so that the servicer can escrow for flood insurance payments along with other escrowing for hazard insurance and taxes. In recognition that the servicer is often not identified prior to closing, the joint final rule requires notice to the servicer as promptly as practicable after the lender provides notice to the borrower, and provides that notice to the servicer must be given no later than at the time the lender transmits to the servicer other loan data concerning hazard insurance and taxes.

Six commenters recommended that the final rule state that a copy of the notice to the borrower would suffice to fulfill the notice requirement to the servicer. The proposal permitted the lender to use the same notice for both the borrower and servicer. That provision is adopted without change in the joint final rule. The proposed rule also has been revised to explicitly state that delivery of a copy of the borrower's notice to the servicer suffices as notice to the servicer.

Several commenters recommended that a separate notice to a servicer affiliated with the lender not be required. The agencies do not agree with this recommendation. The statute requires the lender to notify the servicer of special flood hazards, and the joint final rule reflects this requirement. Moreover, even in the case of servicing by an affiliate, the lender would ordinarily transmit a file to the servicer, either in writing or electronically, to enable the servicer to collect and disburse payments, and the notice of special flood hazards can be transmitted as part of that process without imposing an undue regulatory burden.

The proposed rule has been revised to indicate that the notice to the servicer may be transmitted in written or electronic form.

FEMA or FEMA's Designee. The joint final rule also implements the statutory requirement that, in connection with making, increasing, extending, renewing, selling, or transferring a loan secured by improved real estate or a mobile home located in a SFHA, regulated lenders notify the Director of FEMA or the Director's designee of the identity of the loan servicer and of any change in the servicer. Notice of the identity of the servicer will enable FEMA to provide notice to the servicer of a loan 45 days before the expiration of a flood insurance contract, as required by section 1364(c) of the 1968 Act, as amended. FEMA has designated the insurance provider as its designee to receive notice of the servicer's identity and of any change therein, and at FEMA's request this designation is stated in the joint final rule.

Six commenters requested a model form of notice to the Director of FEMA or the Director's designee, or guidance on the information to be included in the notice. Some commenters suggested that, in the case of a loan subject to RESPA where a Notice of Transfer of servicing to the borrower is required, sending to the Director or the Director's designee a copy of such Notice of Transfer should suffice. The agencies believe that delivery of a copy of the Notice of Transfer, which includes the name, address, and other information concerning the servicer, may be sufficient if the sender includes enough information on or with the notice to enable the Director or the Director's designee to identify the loan and the security property. Other forms of notice also are sufficient if the notice provides information that enables the Director or the Director's designee to identify the loan, the security property, the servicer, and the servicer's address.

Several commenters inquired about electronic transmission of the notice, and one inquired about the possibility of batch transmission. As in the case of notice to the servicer, the joint final rule permits electronic transmission of the notice to the Director or the Director's designee. The agencies also note that nothing in the joint final rule prohibits a timely batch transmission.

Several commenters questioned the need to notify the Director or the Director's designee if the lender or an affiliate of the lender is the loan servicer. The agencies believe that the statute requires notice by the lender to the Director or designee of the initial servicer, and the joint final rule reflects this requirement. However, since the Director has chosen the insurance provider as his designee, the agencies believe that the regulatory burden of notification is minor because there is ordinarily an exchange of information between the lender and the insurance provider at the time a loan is made. Therefore, the agencies have not adopted this suggestion.

Three commenters objected to notifying FEMA when a loan is sold on a ''service released'' basis, where the servicing is sold along with the loan. Failure to provide such notice would defeat the purpose of the requirement, however, as FEMA will have no record of the identity of either the owner or servicer of the loan. The joint final rule is therefore unchanged in this regard.

Three commenters expressed confusion over a lender's obligation in the event of a subsequent transfer of servicing by a transferee servicer, on the grounds that the lender would not necessarily be aware of the transfer. The agencies note that under section 1364(b)(1) of the 1968 Act, as amended, the duty to provide notice to FEMA follows the servicing, and the joint final rule reflects this. Accordingly, the obligation to notify the Director or designee of subsequent changes is transferred to the new servicer along with a transfer of servicing.

Two commenters wanted to limit notice to the ''making'' of a loan and any transfer of servicing, on the grounds that notices in connection with increasing, extending, renewing, selling, or transferring a loan will be redundant. The statute, however, requires notice in all such cases. Moreover, in the case of a loan made before the effective date of the joint final rule, a notice on an increase, extension, renewal, sale, or transfer of the loan will be the first legally required notice to the Director or the Director's designee. Therefore, the

agencies have not adopted this suggestion.

Five commenters argued that it is an unnecessary regulatory burden to notify FEMA when the servicing is transferred or the loan is paid off. The statute requires notice to the Director or the Director's designee when servicing is transferred, but neither the statute nor the joint final rule requires notice when a loan is paid off.

Appendix A—Sample Form of Notice

The agencies received 22 comments on the sample form of notice set forth in appendix A of the proposed regulation. Five commenters asked whether use of the sample form of notice is mandatory. The agencies stress that use of the sample form of notice is not mandatory. A regulated lender may choose to use the sample form as presented in appendix A of the joint final rule to comply with the notice requirements of section 1364 of the 1968 Act. In addition, lenders may personalize, change the format of, and add information to the sample form if they wish to do so. The agencies stress that the sample form merely provides an example of an acceptable form that notice may take. However, to ensure compliance with the notice requirements contained in the joint final rule, a lender-revised notice form must provide the borrower at a minimum with the information in the sample form of notice.

The agencies made several changes to the sample form in response to suggestions from commenters. To streamline the sample form, the agencies combined the introductory paragraphs of the sample notice. The agencies adopted a language change suggested by FEMA regarding the statistical risk of flooding in a SFHA. To increase borrower recognition of their flood insurance responsibilities under the NFIP, the agencies added a reference to the authority and obligation of a regulated lender to force place flood insurance under the 1973 Act. Finally, to clarify that flood insurance is not available for land, the agencies added a sentence that with respect to the amount of flood insurance coverage allowable under the NFIP, the value of the land should be deducted from the overall value of the security property.

Use of Standard Flood Hazard Determination Form

The proposed rule required a regulated lender to use the standard flood hazard determination form (SFHD form) developed by FEMA [32] to determine whether the building or mobile home offered as security property is or will be located in a SFHA in which flood insurance is available under the 1968 Act. The proposed rule allowed the lender to use the form in a printed, computerized or electronic form. The proposed rule required the lender to retain a copy of the completed form, in either hard copy or electronic form, for the period of time the lender owns the loan.

The agencies received 22 comments regarding use of the SFHD form. Four commenters raised issues dealing with the format of the form. For example, two commenters requested clarification about how an electronically maintained form could be used and whether it must be in the same format as the hard-copy form. FEMA addressed the format of an electronically maintained form in the preamble of its final rule adopting the SFHD form.[33] FEMA stated that if an electronic format is used, the format and exact layout of the SFHD form is not required, but the fields and elements listed on the form are required. Any electronic format used by lenders must contain all mandatory fields indicated on the SFHD form.

One commenter asked whether FEMA and the agencies could work together to combine the SFHD form, the notice of flood hazards to the borrower and servicer, and notice commencing the forced placement procedure. The agencies have not adopted this suggestion because the three documents have different purposes. The SFHD form must be used in connection with all loans to determine whether the security property is or will be located in an area having special flood hazards. On the other hand, the notice to the borrower and the servicer must be provided to the borrower and servicer only when the security property is located in a SFHA. The Reform Act does not require the agencies to develop a specific form of notice to borrowers for use in connection with the forced placement procedures. For example, a lender, or servicer acting on the lender's behalf, may choose to send the notice directly. Others may decide to use the insurance company that issues the forced placement policy to send the notice. FEMA has developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with forced placement procedures. For information concerning the contents of the notification letters used under the MPPP, lenders should consult FEMA's MPPP Notice.[34]

Thirteen commenters addressed the topics of the guarantee of information provided by a third party and reliance on a previous determination under section 1365(d) and (e) of the 1968 Act. The agencies' proposed rule did not specifically address these issues, but the preamble discussed them. The preamble explained that the Reform Act permits lenders to rely on third-party flood hazard determinations only if the third party guarantees the accuracy of the information provided to the lender. The Reform Act also permits a lender to rely on a previous determination whether or not the security property is located in a SFHA. A lender is exempt from liability for errors in the previous determination if the previous determination is not more than seven years old and the basis for it was recorded on the SFHD form mandated by the Reform Act. There are, however, two circumstances in which a lender may not rely on a previous determination: (1) if FEMA's map revisions or updates show that the security property is now located in a SFHA, or (2) if the lender contacts FEMA and discovers that map revisions or updates affecting the security property have been made after the date of the previous determination.

Several commenters requested clarification about the statutory provision that a regulated lender may not rely on a previous determination unless the determination was made on FEMA's SFHD form. The agencies believe that this is the correct reading of the statutory provision. Section 1365 of the 1968 Act, as amended by the Reform Act, 42 U.S.C. 4104b, states that a person increasing, extending, renewing, or purchasing a loan secured by improved real estate or a mobile home may rely on a previous determination if the basis for the previous determination was set forth on FEMA's SFHD form.

Two commenters pointed out that pursuant to section 1365 of the 1968 Act, a lender cannot rely on a previous determination set forth on a SFHD form when it makes a loan, only when it increases, extends, renews or purchases a loan. The agencies agree with this interpretation of section 1365 of the 1968 Act but note that subsequent transactions by the same lender with respect to the same property will be

[32] *See* 60 FR 35276 (July 6, 1995) (codified at 44 CFR 65.16 and Appendix A to part 65).

[33] The agencies required regulated lending institutions to use the FEMA-devised SFHD form by means of a joint final rule issued without notice and comment prior to the issuance of the proposal to implement the other Reform Act amendments. The agencies' proposal incorporated that provision. *See* 60 FR 35286 (July 6, 1995).

[34] Notice by FEMA, 60 FR 44881 (August 29, 1995).

treated as renewals and will require no new determination.

The agencies adopt this provision as proposed.

Recordkeeping Requirements

The proposed rule included two recordkeeping requirements: (1) retention of a copy of the completed SFHD form, in either hard copy or electronic form, for the period of time the regulated lender owns the loan; and (2) retention of the record of the receipt of notice to the borrower and the servicer for the period of time the regulated lender owns the loan. In addition, the agencies asked for comment on whether the final rule should require the lender to retain in its files a copy of each notice to FEMA of the identity of the servicer and/or a copy of each mandatory notice to borrowers and servicers. The agencies received 58 comment letters addressing these and other issues pertaining to recordkeeping.

Of the 25 comment letters addressing whether the final regulation should require the lender to retain in its files a copy of the notice to FEMA of the identity of the servicer, 19 commenters believed that such a requirement is unnecessary. Like the proposed rule, the joint final rule does not require that the lender retain in its loan files a copy of the notice to FEMA of the identity of the loan servicer. The joint final rule continues to implement the statutory requirement that lenders must notify FEMA in writing of the identity of the loan servicer and/or of a transfer in servicing rights.

Commenters were mixed in their views whether a regulated lender should be required to maintain a copy in its loan files of the notice to the borrower and the servicer. The joint final rule does not require that a copy of these notices be maintained in the loan files because the Reform Act does not require it.

Like section 1364 of the 1968 Act, as amended, and the proposed rule, the joint final rule requires lenders to retain a record of the receipt of the notices by the borrower and the servicer for the period of time the lender owns the loan. A number of commenters requested clarification about what constitutes a ''record of receipt.'' The joint final rule does not prescribe a particular form for the record of receipt. However, the agencies believe that the record of receipt should contain a statement from the borrower indicating that the borrower has received the notification. Examples of records of receipt may include a borrower's signed acknowledgment on a copy of the notice, a borrower-initialed list of documents and disclosures that the lender provided the borrower, or a scanned electronic image of a receipt or other document signed by the borrower. A lender may keep the record of receipt provided by the borrower and the servicer in the form that best suits the lender's business practices.

Two commenters supported the requirement that lenders must retain a copy of the completed SFHD form, in either hard-copy or electronic form, for the period of time the lender owns the loan. One commenter stated that a copy of the completed form should be retained in the appropriate loan file; the other commenter stated that it need not necessarily be kept in the loan file. The agencies have adopted the SFHD form retention requirement of the proposed rule unchanged. The joint final rule does not specify the location where the copy must be kept. A lender may, but is not required to, retain the copy in the relevant loan file.

Seven commenters stressed that lenders should be able to retain both the record of the receipt of the notices by the borrower and the servicer and the SFHD form in electronic form. As discussed earlier, lenders may retain these records electronically. Lenders are expected, however, to be able to retrieve these electronic records within a reasonable time pursuant to a document request from their Federal supervisory agency.

Agricultural Lending Considerations

Six commenters responded to the discussion in the preamble to the proposal on agricultural lending considerations. The comments generally related to the characteristics that make agricultural lending different from other types of commercial and residential mortgage lending for purposes of flood insurance. Unlike residential lending, where most of the value of the loan collateral is in the residence, in agricultural lending the value of the collateral is concentrated not only in the land, but also in multiple farm buildings. The commenters asserted that it will be difficult to value agricultural buildings for flood insurance purposes. Some agricultural buildings have valuable utility to farm operations but are of relatively nominal market value. Other buildings may have a higher market value but comprise a relatively low percentage of the total loan collateral. Commenters also opined that many agricultural structures would suffer little damage in a flood. To the extent that NFIP flood insurance pricing does not recognize differences in the market value and susceptibility to flood damage of various agricultural structures, commenters asserted that borrowers of regulated agricultural lenders will be forced to pay the same rates for flood insurance as are applicable to other types of commercial structures. Thus, these commenters maintained that participation in the NFIP may be disproportionately expensive for regulated agricultural lenders and their borrowers.

To address these issues, one commenter requested reconsideration of the appropriateness of the proposed regulation for agricultural lending. Another commenter suggested that the agencies create a separate definition for agricultural buildings that would make it possible to treat agricultural structures on a collateral property as a group for flood insurance purposes.

While recognizing that agricultural lenders and their borrowers may be in a different position from others affected by the requirements of the NFIP, the agencies have concluded that Congress did not intend to differentiate agricultural from other types of lenders in the Federal flood insurance legislation. Agricultural lending by commercial banks, thrifts, and credit unions has been covered by the flood insurance statutes since the passage of the 1973 Act. The Reform Act extended the scope of the NFIP to the institutions of the Farm Credit System, which lend substantially in the agricultural sector. The Reform Act clearly identifies the regulated lending institutions covered by the NFIP and offers no leeway for a regulatory exclusion of agricultural lenders. Similarly, issues related to pricing of flood insurance, while obviously significant to regulated lenders and their borrowers, are not within the regulatory purview of the agencies.[35]

As noted in the preamble to the proposal, the FCA encourages Farm Credit System institutions, as well as other agricultural lenders, to work with FEMA to resolve questions regarding the operation and cost structure of the NFIP as it applies to insurance of agricultural structures. In its comment letter on the proposed rule FEMA indicated that it is studying wet floodproofing techniques to determine whether wet floodproofing criteria can be included in the NFIP floodplain management regulations.[36]

[35] As regards the treatment of a group of agricultural buildings for flood insurance purposes, the preamble to the proposal noted that FEMA permits borrowers to insure their nonresidential buildings using one policy with a schedule separately listing the buildings. However, each building must be covered by flood insurance.

[36] In this connection, one commenter questioned why the proposal did not address the effect of

Concurrently, FEMA has indicated that it plans to determine the appropriate flood insurance rates for agricultural structures under the NFIP. Any proposed changes in the NFIP floodplain management regulations will occur through a rulemaking process that provides for public notice and comment. The agencies urge agricultural lenders and their borrowers to participate in pertinent FEMA proceedings so that they may have an opportunity to raise these issues with FEMA. In the agencies' view, these issues are subject to FEMA's administrative and regulatory jurisdiction as administrator of the NFIP.

FEMA Flood Hazard Determination Appeals

The proposed rule did not address the process for appealing flood hazard determinations to FEMA; however, the agencies received eleven letters with comments about various aspects of the process. Many of the commenters' concerns are addressed in FEMA's final rule entitled ''Review of Determinations for Required Purchase of Flood Insurance'' and in the preamble to that final rule.[37] For example, two commenters commented on whether the borrower and the lender must jointly submit an appeal, or whether an appeal submitted by one or the other would be accepted. In its final rule, FEMA clarified that a request must be submitted jointly by the lender and the borrower.

Two commenters recommended that the agencies' final regulation include instructions on how to file a flood determination appeal with FEMA. The agencies believe it is inappropriate to provide this information in the joint final rule because the flood determination appeal process is governed by FEMA and delineated in FEMA's regulations. The agencies understand that FEMA is currently developing a ''sample letter'' with filing instructions for use by lenders and borrowers in submitting an appeal to FEMA.

Three commenters asked which party, the lender or the borrower, should pay FEMA's fee for deciding the appeal. While this is a matter for the lender and the borrower to determine, the agencies believe that the party who requests the appeal of a flood determination generally will bear the cost of the appeal. An appeal is typically initiated at the request of a borrower who believes the property securing the loan is, in fact, not located in an SFHA, despite a flood determination to the contrary. The appeal fee is not charged by the lender as an incident to or condition of the credit. The official staff commentary to Regulation Z provides that charges imposed by someone other than the creditor are generally finance charges only if the creditor requires the borrower to use the third party's services, or the creditor retains the charge.

Finally, four commenters inquired about the flood insurance requirement when a flood determination appeal is in process. FEMA responded to similar questions in the preamble to its final rule. Generally, under section 102(e)(3) of the 1973 Act, 42 U.S.C. 4012a(e)(3), the mandatory flood insurance requirement is temporarily delayed until FEMA responds to an appeal. If FEMA fails to respond before the later of 45 days or the closing of the loan, the mandatory flood insurance purchase requirement is delayed until FEMA provides a response.

Miscellaneous Issues

Standards with respect to purchased loans. Five commenters requested guidance on minimum standards for loan participations and purchased loans. Six other commenters indicated that no guidance on purchased loans is necessary because institutions can manage their own risks internally. Some of those commenters also noted that additional guidance would be tantamount to increased regulatory burden.

If institutions purchasing loans use underwriting standards that address flood insurance, such as requirements for representations from the seller that flood insurance has been purchased for security property located in a special flood hazard area, the agencies agree that no further guidance is necessary. Where an institution's portfolio includes more than an insignificant number of purchased loans and its underwriting standards do not address flood insurance coverage, however, the agencies would expect the institution to have other procedures in place to ensure that it does not expose itself to significant risks through such purchases.

Moreover, the agencies believe that the effects of the Reform Act-mandated standards for flood insurance for loans purchased by Fannie Mae and Freddie Mac should be gauged over a period of time before determining whether further guidance is necessary for institutions in areas that have significant exposure to flood hazards. Institutions with significant lending in non-participating communities should have procedures to ensure that loans on properties in flood hazard areas where flood insurance is not available do not constitute an unacceptably large portion of the institution's loan portfolio.

Subordinate Liens. The agencies received 14 comments concerning flood insurance requirements for second mortgages or home equity loans. Because a second mortgage or a home equity loan is secured by a building or mobile home, these loans are covered by the flood insurance requirements, unless one of the statutory exemptions specifically applies.

Effective Date of Flood Insurance Policies. Some commenters asked about the applicability in various lending situations of the 30-day delay in effectiveness of flood insurance policies as prescribed in section 1306 of the 1968 Act, as amended by the Reform Act, 42 U.S.C. 4013. FEMA addressed this issue in its Policy Issuance 8–95, dated December 5, 1995. FEMA determined that the 30-day waiting period generally is not applicable to the purchase of flood insurance in connection with making, increasing, extending, or renewing a loan.

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act as amended, 5 U.S.C. 605(b), the OCC, Board, FDIC, OTS, and NCUA (banking agencies) hereby certify that this joint final rule will not have a significant economic impact on a substantial number of small entities. Moreover, this joint final rule is required by the Reform Act. Accordingly, a regulatory flexibility analysis is not required.

In response to comments received during the public comment period (a substantial number representing smaller entities), the banking agencies have attempted to minimize regulatory burden by: (1) adding and revising definitions to make technically complex flood insurance rules more readily understood; (2) determining that the purchase of a loan is not the equivalent of the making of a loan for flood insurance purposes; and (3) minimizing the recordkeeping and notice requirements to include only those matters required by the statute.

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section 580 of the Reform Act, 42 U.S.C. 4022(a)(2), with respect to agricultural structures. Section 580 relates to flood mitigation and floodplain management efforts under the NFIP and is not directly relevant to these regulations, which implement the Reform Act provisions pertaining to regulated lenders. Section 580 does appear pertinent, however, to wet floodproofing and other questions relating to coverage of certain repeated loss agricultural structures under the NFIP, which may be the subject of FEMA rulemaking.

[37] *See* 60 FR 62213 (December 5, 1995) (to be codified at 44 CFR 65.17).

As a general matter, the joint final rule does not impose standards that are in excess of industry standards with respect to flood insurance, as those standards are reflected in the underwriting standards for Fannie Mae and Freddie Mac. Further, for those lenders already covered by existing flood insurance requirements, the joint final rule does not represent a significant increase over the burden imposed under the current rules. For such lenders, the joint final rule would increase burden above that imposed under the current rules in the following cases: (1) where residential property securing a loan is located in a special flood hazard area and the lender requires escrows for other tax and insurance payments, premiums for required flood insurance must be escrowed as well; (2) the content of the notices currently provided to borrowers is modified to provide additional information to the borrower; and (3) notice to FEMA of the servicer of the loan secured by property located in a special flood hazard area is required to permit FEMA to contact the servicer if the flood insurance lapses.[38] The banking agencies believe that these increases in burden will result only in minor additional expenses for depository institutions.

V. Paperwork Reduction Act of 1995

The OCC, Board, FDIC, OTS, and NCUA (banking agencies) invite comment on:

(1) Whether the collection of information contained in this joint final rule is necessary for the proper performance of each agency's functions, including whether the information has practical utility;

(2) The accuracy of each agency's estimate of the burden of the information collection;

(3) Ways to enhance the quality, utility, and clarity of the information to be collected; and

(4) Ways to minimize the burden of the information collection on respondents, including the use of automated collection techniques or other forms of information technology.

The banking agencies asked similar questions in the proposal. Several commenters indicated that the banking agencies had underestimated the paperwork burden associated with the flood rules. For purposes of allocating the paperwork burden for the flood rules, FEMA is charged with the hours for *completing* the SFHD form (FEMA form 81–93; OMB Control No. 3067–0264), while the banking agencies are charged with the *recordkeeping* burden associated with the SFHD form and the notifications and additional recordkeeping required when a property is located in a SFHA. The separation of burden responsibility and reporting easily could cause the paperwork burden of these rules to appear to be understated. When viewed in conjunction with FEMA's burden, however, the banking agencies believe that the recordkeeping and notification burden estimates associated with these rules are reasonable.

Respondents/recordkeepers are not required to respond to this collection of information unless it displays a currently valid OMB control number.

OCC: The collection of information requirements contained in the OCC's portion of this joint final rule have been approved by the Office of Management and Budget under OMB Control No. 1557–0202 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information requirements should be sent to the Office of Management and Budget, Paperwork Reduction Project (1557–0202), Washington, DC 20503, with a copy to the Legislative and Regulatory Activities Division (1557–0202), Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219.

The collection of information requirements relating to the OCC's portion of this joint final rule are found in 12 CFR 22.6, 22.7, 22.9, and 22.10. This information is required to evidence compliance with the requirements of the NFIP with respect to lenders (national banks) and borrowers (anyone who applies for a loan secured by improved real property or a mobile home which may be located in a SFHA). The likely respondents/recordkeepers are national banks.

Estimated average annual burden hours per respondent/recordkeeper: 26 hours.

Estimated number of respondents and/or recordkeepers: 3,000.

Estimated total annual reporting and recordkeeping burden: 78,000 hours.

Start-up costs to respondents: None.

Records are to be maintained for the period of time the respondent/recordkeeper owns the loan.

Board: In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(i); *see also* 5 CFR 1320 Appendix A Item 1), the Board reviewed its portion of this joint final rule under the authority delegated to the Board by the Office of Management and Budget and assigned OMB control number 7100–0280. Send comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100–0280), Washington, DC 20503.

The collection of information requirements relating to the Board's portion of this joint final rule are included in 12 CFR 208.23. This information is required to evidence compliance with the requirements of the NFIP with respect to lenders (state chartered member banks) and borrowers (anyone who applies for a loan secured by improved real property or a mobile home which may be located in a SFHA). The respondents/recordkeepers are for-profit financial institutions, including small businesses.

It is estimated that there will be 1,042 respondent/recordkeepers and a total of 26,800 hours of annual hour paperwork burden. The estimated annual hour paperwork burden per respondent/recordkeeper is 25.7 hours, 1 hour for recordkeeping and a total of 24.7 hours for: (1) Notifying the borrower and the servicer; (2) notifying the Director of FEMA of initial servicers; and (3) if necessary, notifying the Director of FEMA when a loan servicer has changed. Banks likely will add the required records to their existing usual and customary loan documentation. Thus there is estimated to be no significant annual cost burden over the annual hour burden. Additionally, the Board estimates that there is no associated capital or start up cost as banks are expected to use their current word processing programs to produce the notices.

Records are to be maintained for the period of time the respondent/recordkeeper owns the loan. Because the records would be maintained at state member banks and the notices are not provided to the Board, no issue of confidentiality under the Freedom of Information Act arises.

FDIC: The collections of information contained in the FDIC's portion of this joint final rule have been approved by the Office of Management and Budget under OMB Control No. 3064–0120 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget,

[38] The provision concerning forced placement of flood insurance is self-implementing and is included in the joint final rule only to ensure that regulated lenders are aware of the authority and requirements of that provision. Including the provision in the joint final rule does not impose any additional burden on regulated lenders.

Paperwork Reduction Project (3064–0120), Washington, DC 20503, with copies of such comments to be sent to Steven F. Hanft, Office of the Executive Secretary, Room F–453, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

The collections of information requirements relating to the FDIC's portion of this joint final rule are found in 12 CFR 339.6, 339.7, 339.9, and 339.10. This information is required to evidence compliance with the requirements of the NFIP with respect to lenders (state chartered nonmember banks) and borrowers (anyone who applies for a loan secured by improved real estate or a mobile home which may be located in a SFHA).

The likely respondents/recordkeepers are insured nonmember banks and their subsidiaries.

Estimated number of respondents/recordkeepers: 6,250.

Estimated average annual burden hours per respondent/recordkeeper: 26 hours.

Estimated total annual reporting and recordkeeping burden: 162,500 hours.

Start-up costs to respondents: None.

Records are to be maintained for the period of time the respondent/recordkeeper owns the loan.

OTS: The collection of information requirements contained in the OTS's portion of this joint final rule have been approved by the Office of Management and Budget under OMB Control No. 1550–0088 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (1550–0088), Washington, DC 20503, with a copy to the OTS, 1700 G Street, NW., Washington, DC 20552.

The collection of information requirements relating to the OTS's portion of this joint final rule are found in 12 CFR 572.6, 572.7, 572.9, and 572.10. This information is required to evidence compliance with the requirements of the NFIP with respect to lenders (savings associations) and borrowers (anyone who applies for a loan secured by improved real property or a mobile home which may be located in a SFHA). The likely recordkeepers are OTS-regulated savings associations.

Estimated number of respondents and/or recordkeepers: 1,500.

Estimated average annual burden hours per recordkeeper: 26 hours.

Estimated total annual reporting and recordkeeping burden: 39,000 hours.

Start-up costs to respondents: None.

Records are to be maintained for the period of time respondent/recordkeeper owns the loan.

NCUA: The collection of information requirements contained in the NCUA's portion of this joint final rule were approved by the Office of Management and Budget under OMB Control No. 3133–0143. Written comments on the collection of information should be sent to the Office of Management and Budget, OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, DC 20503. Attn: Alexander Hunt.

The collection of information requirements relating to the NCUA's portion of this joint final rule are found in 12 CFR 760.6, 760.7, 760.9 and 760.10. This information is required to evidence compliance with the requirements of the NFIP with respect to lenders (Federally-insured credit unions) and borrowers (members that apply for a loan secured by improved real estate or a mobile home which may be located in a SFHA). The likely recordkeepers are Federally-insured credit unions.

Estimated number of respondents and/or recordkeepers: 700.

Estimated average annual burden hours per respondent/recordkeeper: 26 hours.

Estimated total annual reporting and recordkeeping burden: 16,325 hours.

Start-up costs to respondents: None.

Records are to be maintained for the period of time the respondent/recordkeeper owns the loan.

VI. Executive Order 12866

OCC and OTS: The OCC and the OTS each has determined that its portion of this joint final rule is not a significant regulatory action as defined in Executive Order 12866.

VII. Executive Order 12612

Executive Order 12612 requires the NCUA to consider the effects of its actions on State interests. The NCUA's portion of this joint final rule will apply to all Federally-insured credit unions and reduce regulatory requirements. The NCUA Board has determined that the NCUA's portion of the joint final rule would not have a substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

VIII. Unfunded Mandates Reform Act of 1995

OCC and OTS: Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104–4, 109 Stat. 48 (1995) (Unfunded Mandates Act) requires that covered agencies prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires covered agencies to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. As discussed in the preamble, this joint final rule revises current OCC and OTS flood insurance regulations as prescribed by the Reform Act. The Reform Act specifically requires six agencies, including the OCC and OTS, to implement certain of the Reform Act's amendments through regulations. Therefore, to the extent that the joint final rule imposes new Federal requirements, the requirements are statutorily mandated by the Reform Act. Nevertheless, the OCC and OTS each has determined that its portion of the joint final rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more in any one year. Accordingly, the OCC and OTS have not prepared budgetary impact statements or specifically addressed the regulatory alternatives considered.

List of Subjects

12 CFR Part 22

Flood insurance, Mortgages, National banks, Reporting and recordkeeping requirements.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Flood insurance, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 339

Flood insurance, Reporting and recordkeeping requirements.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Flood insurance, Investments, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

12 CFR Part 572

Flood insurance, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 614

Agriculture, Banks, banking, Flood insurance, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 760

Credit unions, Mortgages, Flood insurance, Reporting and recordkeeping requirements.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 791

Rules of NCUA Board Procedure; Promulgation of NCUA Rules and Regulations; Public Observation of NCUA Board Meetings

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: This rule amends NCUA's current regulations on NCUA Board procedure by providing that items will be placed on the Board agenda by determination of the Chairman or at the request of any two Board members. This amendment more clearly defines the authority of the Board members in setting the agenda.

EFFECTIVE DATE: This amendment is effective October 25, 1996.

FOR FURTHER INFORMATION CONTACT: Robert M. Fenner, General Counsel, Office of the General Counsel, at the above address or telephone (703) 518–6540. E-mail questions may be sent to ogcmail@ncua.gov.

SUPPLEMENTARY INFORMATION: NCUA's Rules of Board Procedure, 12 CFR part 791, govern the manner in which the Board acts on behalf of NCUA; the conduct, scheduling and subject matter of Board meetings, the use of notation votes, and the recording of Board actions. Prior to this amendment, Section 791.6(a) vested final authority to determine the agenda for a particular Board meeting with the Chairman.

The NCUA Board has determined that any two Board members shall have the ability to have an item considered by the Board within 60 days of a written request that includes an NCUA ''B–1 Form'' and a Board Action Memorandum. Accordingly, section 791.6(a) is amended to provide that the Chairman determines the *order* of the meeting agenda, and that items shall be placed on the agenda either by determination of the Chairman, or within 60 days of the submission of such a request by any two Board members. At the same time, section 791.6(b) is amended to clarify that *recommended* agenda items may be submitted by Board members and Office Directors; actual agenda items are determined by the Chairman and Board.

Immediate Effective Date

Because this amendment concerns rules of NCUA Board procedure, prior notice and public comment are not required by 5 U.S.C. 553, and the rule is effective upon publication in the **Federal Register**.

Regulatory Procedures

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, the NCUA hereby certifies that this rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This rule affects internal NCUA Board operations only. Thus, it will not result in additional burden for regulated institutions. The purpose of this rule is to enhance the operations of the NCUA Board.

Paperwork Reduction Act

The amendments do not contain any collection of information requirements.

Executive Order 12612

The rule, like the provision of part 791 it replaces, only applies to the NCUA Board. Accordingly, the Board has determined that the rule will not have a substantial direct effect on the states, on the relationship between that national government and the states, or on the distribution of power and responsibilities among various levels of government. Further, the rule will not preempt provisions of state law or regulations.

List of Subjects in 12 CFR Part 791

Administrative practice and procedure, Sunshine Act.

By the National Credit Union Administration Board on October 16, 1996.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 747

Civil Monetary Penalty Inflation Adjustment

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: Congress, in the Federal Civil Monetary Penalty Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, required all federal agencies with the authority to impose civil monetary penalties (CMPs) to regularly evaluate those CMPs to ensure that they continue to maintain their deterrent value. As a result of these acts, the head of each agency is required, by October 23, 1996, and at least once every four years thereafter, to adjust its CMPs for inflation. In order to comply with Congress' mandate, the National Credit Union Administration is issuing this final rule to implement the required adjustments to the CMPs authorized by the Federal Credit Union Act.

EFFECTIVE DATE: November 6, 1996.

FOR FURTHER INFORMATION CONTACT: Allan Meltzer, Associate General Counsel, or Jon Canerday, Trial Attorney, Office of General Counsel, NCUA, 1775 Duke Street, Alexandria, Virginia 22314, or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION: The Debt Collection Improvement Act of 1996 (DCIA)[1] amended the Federal Civil Monetary Penalty Inflation Adjustment Act of 1990[2] (FCMPIA Act) to require every Federal agency to enact regulations that adjust each civil monetary penalties (CMPs)[3] provided by law under its jurisdiction by the rate of inflation pursuant to the inflation adjustment formula in section 5(b) of the FCMPIA Act. Each Federal agency is required to issue these implementing regulations by October 23, 1996, which is 180 days after the date that DCIA was enacted, and at least once every 4 years thereafter. Section 7 of the amended FCMPIA Act specifies that inflation-adjusted CMPs will only apply to violations that occur after October 23, 1996.

The inflation adjustment is based on the percentage increase in the Consumer Price Index (CPI)[4] for the period from June of the calendar year when the CMP was established or last adjusted until June of the calendar year preceding the adjustment. Furthermore, each CMP that has been adjusted for inflation must be rounded to a number prescribed by section 5(a) of the FCMPIA Act.[5] Another provision of the DCIA limits the first adjustment of a CMP to an amount not to exceed 10 percent of the original penalty. The amount of increase in the final regulation would have been more if this limit did not exist.

Section 206(k)(2) of the Federal Credit Union Act (12 U.S.C. 1786(k)(2)) authorizes the National Credit Union Administration (NCUA) to impose three levels or tiers of CMPs upon insured credit unions or institution-affiliated parties. First tier CMPs, 12 U.S.C. 1786(k)(2)(A), may be imposed for the violation of any law or regulation, the violation of certain final orders or temporary orders, the violation of conditions imposed in writing by the NCUA Board, or the violation of any written agreement between the credit union and NCUA. The statute presently provides that first tier CMPs shall not be more than $5,000 for each day the violation continues. After the required adjustment for inflation, the maximum penalty is increased to $5,500 for each day.

Second tier CMPs, 12 U.S.C. 1786(k)(2)(B), are authorized for violations described in first tier CMPs, the reckless engaging in an unsafe or unsound practice in conducting the affairs of a credit union, or the breach of any fiduciary duty, when the violation, practice or breach is part of a pattern of misconduct, or causes or is likely to cause more than a minimal loss to the credit union, or results in pecuniary gain or other benefit. The maximum second tier CMP is currently $25,000 for each day the violation, practice or breach continues. After the required adjustment for inflation, the maximum penalty is increased to $27,500 per day.

Third tier CMPs, 12 U.S.C. 1786(k)(2)(C), may be imposed for any of the acts described in second tier CMPs that cause a substantial loss to the credit union or a substantial pecuniary gain or other benefit. The amount of third tier CMPs depends upon the status of the respondent required to pay the CMP (12 U.S.C. 1786(k)(2)(D)). For a person other than an insured credit union, the current maximum third tier CMP is $1,000,000 for each day the violation, practice or breach continues. For an insured credit union, the current daily maximum CMP is the lesser of $1,000,000 or 1 percent of the total assets of the credit union. The maximum CMP for a person other than an insured credit union will be increased for inflation to $1,100,000 per day. The maximum CMP for an insured credit union will be increased to the lesser of $1,100,000 or 1 percent of the total assets of the credit union.

The NCUA now adopts this final rule which adjusts these three CMPs for the rate of inflation, as required by the DCIA. DCIA provides Federal agencies with no discretion in the adjustment of CMPs for inflation, and it also requires the new regulation to take effect on October 23, 1996. Further, the regulation that the NCUA adopts today to implement DCIA is ministerial and technical. For these reasons, the NCUA finds good cause to determine that public notice and comment for this new regulation is unnecessary, impractical and contrary to the public interest, pursuant to the Administrative Procedure Act (APA), 5 U.S.C. 553(a)(3)(B). These same reasons also provide the NCUA with good cause to adopt an effective date for this regulation that is less than 30 days after the date of publication in the **Federal Register**. Furthermore, the NCUA determines that pursuant to the requirements of section 808 of the Small Business Regulatory Enforcement Fairness Act of 1996, this regulation shall take effect prior to the expiration of the 60-day Congressional waiting period for final NCUA regulatory action due to the Congressionally-mandated effective date of October 23, 1996.

Regulatory Requirements

Regulatory Flexibility Act

The NCUA has determined and certifies that the final rule will not have a significant impact on a substantial number of small credit unions (primarily those under $1,000,000 in assets).

Paperwork Reduction Act

No collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) are contained in the final rule. Consequently, no information has been

[1] Pub. L. 104–134, section 31001(s), 110 Stat. 1321–358, (Apr. 26, 1996). The provision is codified at 28 U.S.C. 2461 *note*.

[2] Pub. L. 101–410, 104 Stat. 890, (Oct. 5, 1990).

[3] Section 3(2) of the amended FCMPIA Act defines a CMP as any penalty, fine, or other sanction that: (1) either is for a specific monetary amount as provided by Federal law or has a maximum amount provided for by Federal law; (2) is assessed or enforced by an agency pursuant to Federal law; and (3) is assessed or enforced pursuant to an administrative proceeding or a civil action in the Federal courts.

[4] The CPI is published by the Department of Labor, Bureau of Statistics.

[5] For example, an increase that is less than $100 would be rounded to the nearest multiple of $10, and an increase over $100 but less than $1,000 would be rounded to the nearest multiple of $100.

submitted to the Office of Management and Budget for review.

Executive Order 12612

The NCUA Board, pursuant to Executive Order 12612, has determined that this final rule will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government.

List of Subjects in 12 CFR Part 747

Administrative practice and procedure, Credit unions, Penalties.

By the National Credit Union Administration Board on October 28, 1996.

Becky Baker,

Secretary to the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 747

Civil Monetary Penalty Inflation Adjustment

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: Congress, in the Federal Civil Monetary Penalty Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, required all federal agencies with the authority to impose civil monetary penalties (CMPs) to regularly evaluate those CMPs to ensure that they continue to maintain their deterrent value. As a result of these acts, the head of each agency is required, by October 23, 1996, and at least once every four years thereafter, to adjust its CMPs for inflation. In order to comply with Congress' mandate, the National Credit Union Administration is issuing this final rule to implement the required adjustments to the CMPs authorized by the Federal Credit Union Act.

EFFECTIVE DATE: November 6, 1996.

FOR FURTHER INFORMATION CONTACT: Allan Meltzer, Associate General Counsel, or Jon Canerday, Trial Attorney, Office of General Counsel, NCUA, 1775 Duke Street, Alexandria, Virginia 22314, or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION: The Debt Collection Improvement Act of 1996 (DCIA)[1] amended the Federal Civil Monetary Penalty Inflation Adjustment Act of 1990[2] (FCMPIA Act) to require every Federal agency to enact regulations that adjust each civil monetary penalties (CMPs)[3] provided by law under its jurisdiction by the rate of inflation pursuant to the inflation adjustment formula in section 5(b) of the FCMPIA Act. Each Federal agency is required to issue these implementing regulations by October 23, 1996, which is 180 days after the date that DCIA was enacted, and at least once every 4 years thereafter. Section 7 of the amended FCMPIA Act specifies that inflation-adjusted CMPs will only apply to violations that occur after October 23, 1996.

The inflation adjustment is based on the percentage increase in the Consumer Price Index (CPI)[4] for the period from June of the calendar year when the CMP was established or last adjusted until June of the calendar year preceding the adjustment. Furthermore, each CMP that has been adjusted for inflation must be rounded to a number prescribed by section 5(a) of the FCMPIA Act.[5] Another provision of the DCIA limits the first adjustment of a CMP to an amount not to exceed 10 percent of the original penalty. The amount of increase in the final regulation would have been more if this limit did not exist.

Section 206(k)(2) of the Federal Credit Union Act (12 U.S.C. 1786(k)(2)) authorizes the National Credit Union Administration (NCUA) to impose three levels or tiers of CMPs upon insured credit unions or institution-affiliated parties. First tier CMPs, 12 U.S.C. 1786(k)(2)(A), may be imposed for the violation of any law or regulation, the violation of certain final orders or temporary orders, the violation of conditions imposed in writing by the NCUA Board, or the violation of any written agreement between the credit union and NCUA. The statute presently provides that first tier CMPs shall not be more than $5,000 for each day the violation continues. After the required adjustment for inflation, the maximum penalty is increased to $5,500 for each day.

Second tier CMPs, 12 U.S.C. 1786(k)(2)(B), are authorized for violations described in first tier CMPs, the reckless engaging in an unsafe or unsound practice in conducting the affairs of a credit union, or the breach of any fiduciary duty, when the violation, practice or breach is part of a pattern of misconduct, or causes or is likely to cause more than a minimal loss to the credit union, or results in pecuniary gain or other benefit. The maximum second tier CMP is currently $25,000 for each day the violation, practice or breach continues. After the required adjustment for inflation, the maximum penalty is increased to $27,500 per day.

Third tier CMPs, 12 U.S.C. 1786(k)(2)(C), may be imposed for any of the acts described in second tier CMPs that cause a substantial loss to the credit union or a substantial pecuniary gain or other benefit. The amount of third tier CMPs depends upon the status of the respondent required to pay the CMP (12 U.S.C. 1786(k)(2)(D)). For a person other than an insured credit union, the current maximum third tier CMP is $1,000,000 for each day the violation, practice or breach continues. For an insured credit union, the current daily maximum CMP is the lesser of $1,000,000 or 1 percent of the total assets of the credit union. The maximum CMP for a person other than an insured credit union will be increased for inflation to $1,100,000 per day. The maximum CMP for an insured credit union will be increased to the lesser of $1,100,000 or 1 percent of the total assets of the credit union.

The NCUA now adopts this final rule which adjusts these three CMPs for the rate of inflation, as required by the DCIA. DCIA provides Federal agencies with no discretion in the adjustment of CMPs for inflation, and it also requires the new regulation to take effect on October 23, 1996. Further, the regulation that the NCUA adopts today to implement DCIA is ministerial and technical. For these reasons, the NCUA finds good cause to determine that public notice and comment for this new regulation is unnecessary, impractical and contrary to the public interest, pursuant to the Administrative Procedure Act (APA), 5 U.S.C. 553(a)(3)(B). These same reasons also provide the NCUA with good cause to adopt an effective date for this regulation that is less than 30 days after the date of publication in the **Federal Register**. Furthermore, the NCUA determines that pursuant to the requirements of section 808 of the Small Business Regulatory Enforcement Fairness Act of 1996, this regulation shall take effect prior to the expiration of the 60-day Congressional waiting period for final NCUA regulatory action due to the Congressionally-mandated effective date of October 23, 1996.

Regulatory Requirements

Regulatory Flexibility Act

The NCUA has determined and certifies that the final rule will not have a significant impact on a substantial number of small credit unions (primarily those under $1,000,000 in assets).

Paperwork Reduction Act

No collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) are contained in the final rule. Consequently, no information has been

[1] Pub. L. 104–134, section 31001(s), 110 Stat. 1321–358, (Apr. 26, 1996). The provision is codified at 28 U.S.C. 2461 *note*.

[2] Pub. L. 101–410, 104 Stat. 890, (Oct. 5, 1990).

[3] Section 3(2) of the amended FCMPIA Act defines a CMP as any penalty, fine, or other sanction that: (1) either is for a specific monetary amount as provided by Federal law or has a maximum amount provided for by Federal law; (2) is assessed or enforced by an agency pursuant to Federal law; and (3) is assessed or enforced pursuant to an administrative proceeding or a civil action in the Federal courts.

[4] The CPI is published by the Department of Labor, Bureau of Statistics.

[5] For example, an increase that is less than $100 would be rounded to the nearest multiple of $10, and an increase over $100 but less than $1,000 would be rounded to the nearest multiple of $100.

submitted to the Office of Management and Budget for review.

Executive Order 12612

The NCUA Board, pursuant to Executive Order 12612, has determined that this final rule will not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government.

List of Subjects in 12 CFR Part 747

Administrative practice and procedure, Credit unions, Penalties.

By the National Credit Union Administration Board on October 28, 1996.

Becky Baker,

Secretary to the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Organization and Operations of Federal Credit Unions

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule and withdrawal of amendments to Interpretive Ruling and Policy Statement 94–1.

SUMMARY: The NCUA Board has withdrawn Interpretive Ruling and Policy Statement 96–2 (IRPS 96–2) that was published in 61 FR 59305 (November 22, 1996). The NCUA Board has determined that subsequent legal events make the withdrawal of IRPS 96–2 appropriate.

DATES: This rule is effective February 5, 1997.

FOR FURTHER INFORMATION CONTACT: John Ianno, Trial Attorney, Office of General Counsel or Michael J. McKenna, Acting Associate General Counsel, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428 or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION: On November 14, 1996, the Board issued an interim final Interpretive Ruling and Policy Statement (IRPS 96–2) to permit federal credit unions to restructure their fields of membership consistent with court decisions limiting federal credit union's ability to serve eligible credit union members and new select groups. Two events have caused the Board to conclude that withdrawal of IRPS 96–2 is appropriate at this time. First, on December 4, 1996, the U.S. District Court for the District of Columbia issued an Order invalidating IRPS 96–2 and enjoining NCUA from implementing it. Second, on December 24, 1996, the U.S. Court of Appeals for the District of Columbia Circuit issued a partial stay of the District Court's earlier injunction which prevented federal credit unions from serving new members of select employee groups which were within their existing field of membership. The NCUA Board will consider further regulatory action at an appropriate time depending on developments in the ongoing litigation concerning field of membership issues.

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on January 23, 1997.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 790 and 792

Description of NCUA; Requests for Agency Action and Requests for Information Under the Freedom of Information Act and Privacy Act, and by Subpoena; Security Procedures for Classified Information

AGENCY: National Credit Union Administration (NCUA)

ACTION: Final rule

SUMMARY: Due to changes in the credit union environment, in October of 1996, the NCUA authorized a change in the mission and a corresponding name change of the Asset Liquidation and Management Center (ALMC). The new name is the Asset Management and Assistance Center (AMAC). A description of the new AMAC replaces the description of the ALMC. In addition, AMAC replaces ALMC in another part of the regulations.

EFFECTIVE DATE: Effective February 24, 1997.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314–3428.

FOR FURTHER INFORMATION CONTACT: Hattie M. Ulan, Special Counsel to the General Counsel at the above address or telephone: 703–518–6540.

SUPPLEMENTARY INFORMATION: The NCUA Board established the Asset Liquidation Management Center (ALMC) in July 1988, to deal with an emerging concentration of real estate assets in a limited number of troubled credit unions. The mission of the ALMC was to minimize losses to the National Credit Union Share Insurance Fund by managing and disposing of real estate assets acquired from troubled credit unions. In February of 1990, the Board added the agency's liquidation activity to the ALMC. Although the number of liquidations are down, liquidations have become increasingly complex. The ALMC's responsibilities have expanded to include the review of large, complex loan portfolios, assistance in uncovering and developing bond claims and complex record reconstruction. The ALMC provides additional depth, experience and resources in liquidation related as well as other matters to NCUA's six regional offices.

The Board believed that the name ALMC did not accurately reflect the responsibilities the center was carrying out. Therefore, in October 1996, the Board officially changed the name to Asset Management and Assistance Center (AMAC). The Board is now amending its regulation which describes the duties of AMAC, formerly the ALMC. The description of the office is found in 12 CFR 790.2(b)(4). There is also a reference to ALMC in 12 CFR 792.2(f). This paragraph describes information centers for purposes of requesting materials under the Freedom of Information Act. The reference is corrected to read AMAC. An additional sentence is added to paragraph 792.2(f) to indicate that the President of the AMAC is responsible for the operation of the information center maintained there. This is a technical addition of a responsibility already delegated to the President of AMAC.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic impact any regulation may have on a substantial number of small credit unions. The changes made by this rule are merely housekeeping changes. Therefore, the NCUA Board has determined and certifies that, under the authority granted in 5 U.S.C. 605(b), this final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the Board has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

This final rule does not change any paperwork requirements.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. Since these are housekeeping changes only, there is no effect on state interests.

List of Subjects in 12 CFR Parts 790 and 792

Credit Unions.

By the National Credit Union Administration Board on February 13, 1997.

Becky Baker,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 704, 709, and 741

RIN 3133–AB67

Corporate Credit Unions; Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims Involving Federally Insured Credit Unions in Liquidation; Requirements for Insurance

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is issuing a final rule governing corporate credit unions. The rule strengthens capital requirements, establishes parameters to ensure that the risk on corporate credit union balance sheets is adequately managed, provides for corporate credit unions with more developed systems and infrastructures to take more planned and controlled risk, and sets forth special rules for wholesale corporate credit unions.

EFFECTIVE DATE: January 1, 1998.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: Robert F. Schafer, Director, Office of Corporate Credit Unions, at the above address or telephone (703) 518–6640; or Edward Dupcak, Director, Office of Investment Services, at the above address or telephone (703) 518-6620.

SUPPLEMENTARY INFORMATION:

A. Background

In April 1995, NCUA issued a proposed regulation to revise most of Part 704. 60 FR 20438, Apr. 26, 1995. In response to the comments received and results of risk-profile assessments of corporate credit unions using simulated modeling techniques, NCUA determined to issue a revised proposed rule for another round of public comment. 61 FR 28085, June 4, 1996. The proposed rule provided for a 90-day comment period, ending on September 3, 1996. On July 16, 1996, NCUA issued a proposed rule addressing the special circumstances of wholesale corporate credit unions. 61 FR 38117, July 23, 1996. The comment period to this proposal also ended on September 3, 1996. The comment period for both proposals subsequently was extended to October 18, 1996. 61 FR 41750, August 12, 1996. This final rule addresses both proposals.

A total of 289 comments were received on the proposals, 202 from natural person credit unions, 36 from corporate credit unions, 24 from state banking trade associations; 10 from state credit union leagues, 5 from state credit union regulatory authorities, 4 from national credit union trade associations, 4 from credit union organizations and consultants, 3 from other entities that do business with credit unions, and 1 from another type of trade association. The commenters complimented NCUA's efforts to strengthen the regulation and stated that progress had been made from the previous proposal but that changes were still necessary.

A general comment was a request to standardize the time frames for corporate credit unions to take various actions described throughout the regulation. The proposed regulation required corporate credit unions to take action in some cases in business days and in others in calendar days. There also were five different numbers of days for those actions. To make compliance easier, all dates in the final regulation have been changed to calendar days, and the number of days for compliance has been reduced to either 10 days, when only notification is required, or 30 days, when more substantive action is required.

A common thread in many of the comments was the comparison of corporate credit unions with natural person credit unions, banks, savings and loans, and other financial institutions. Another was the suggestion that NCUA take the same approach with corporate credit unions as its sister federal financial institution regulatory agencies take with their respective institutions. While these comparisons are understandable, NCUA cautions that in many cases, they are not appropriate.

Corporate credit unions differ from natural person credit unions, banks, savings institutions, and other financial institutions that serve consumers. They serve exclusively one class of customer: credit unions. Corporate credit union balance sheets, cash flows, and liquidity demands differ significantly from those of other financial institutions. In general, the volume of large dollar transactions present unique risks not seen in consumer-oriented institutions. As a result, while considering comparisons with other institutions and sister agencies, NCUA has been careful to put those comparisons into proper perspective and to regulate to the areas of risk.

A number of commenters strongly suggested that NCUA review the corporate regulation on an annual basis. While NCUA believes that a periodic review is necessary, it believes that circumstances and need should determine the frequency. NCUA has identified a number of issues, some of which are identified in this supplementary information section, that warrant further study relatively soon after the regulation is implemented. Accordingly, the Office of Corporate Credit Unions will present a report of these and other issues within 18 months of publication of the final rule.

B. Section-by-Section Analysis

Section 704.1—Scope

Part 704 applies directly to all federally insured corporate credit unions. It applies to non federally insured corporate credit unions, via Part 703 of the Rules and Regulations, if such credit unions accept shares from federally chartered credit unions. To clarify the application of Part 704, the proposed rule added language to the Scope section stating that non federally insured corporate credit unions must agree, by written contract, to adhere to the regulation and submit to NCUA examination as a condition of receiving funds from federally insured credit unions. Although a few commenters questioned the need for such a contract, the language has been retained in the final rule. Since the majority of natural person credit unions are federally insured, NCUA has a strong interest in ensuring that corporate credit unions which accept their funds remain safe and sound institutions.

Proposed Section 704.1(b), which set forth NCUA's authority to waive a requirement of Part 704, is retained in this final rule. NCUA may use this authority to respond to innovation at corporate credit unions and in the marketplace. NCUA envisions the approval of pilot programs involving new investments or activities. Such programs would be approved on a limited basis so that NCUA could assess their impact on corporate credit unions.

Language has been added to clarify that a state chartered corporate credit union's request for expanded authority must be approved by the state supervisory authority before being submitted to NCUA.

Section 704.2—Definitions

The proposed rule added a number of new definitions, revised others, and deleted some. A few commenters took exception to specific proposed definitions. Their comments and NCUA's responses are discussed below.

In response to a comment, the definitions of the following terms have been changed from the language that was proposed. The definition of ''adjusted trading'' has been amended to include transactions not ''used to defer

a loss.'' The definition of collateralized mortgage obligation has been changed so that the collateral may consist simply of ''mortgages,'' rather than ''whole loan mortgages.'' The word ''may'' has been added to the definition of ''commitment'' so that the list of items included in the term is not absolute. Although the definition of ''expected maturity'' was proposed to be deleted, it has been retained. A commenter noted that the term is used in the definitions of ''long-term investment'' and ''short-term investment.'' The definition of ''federal funds'' has been broadened to include transactions with domestic branches of foreign banks, various government-sponsored enterprises, and other non depository entities. The definition of ''securities lending'' has been expanded to more precisely describe the activity. The definition of ''wholesale corporate credit union'' has been changed in light of the addition of Section 701.19 to the regulation.

The proposed definition that elicited the most comments was that for ''market value of portfolio equity (MVPE).'' The proposed definition treated membership capital as a liability, rather than as part of MVPE. A number of commenters urged that it be included in MVPE. Before addressing that issue, it must be noted that NCUA has determined to replace the term MVPE in the rule with that of net economic value (NEV). The calculation itself has not been altered, merely renamed. The adoption of the term ''net economic value'' in place of ''market value of portfolio equity'' is preferred because of the potential confusion that results from the integral terms ''market'' and ''portfolio.'' The calculation of estimated fair value, for both assets and liabilities, is not only obtained from market sources. The term ''portfolio'' is more typically used to describe investment or loan assets in contrast to an entire balance sheet. While MVPE is a commonly used term in the profession of asset and liability management, many practitioners and other financial regulators have recently opted for new terminology. NEV better connotes the concept of intrinsic or fair value of the whole balance sheet than does MVPE.

The suggestion that ''capital is capital,'' whatever its form, is the basis for the argument that corporate credit unions should be permitted to include secondary capital in the base for all risk-taking activities. The calculation of NEV serves as the base for credit and interest rate risk limits as well as other activity restrictions, and many commenters suggested that corporate credit unions should have as much risk-taking potential as possible. NCUA disagrees that membership capital should be included in the definition of NEV.

The function of membership capital is to serve as a secondary resource for the absorption of risk when reserves and undivided earnings have been exhausted. The holder of membership capital has the option to sell the shares back to the corporate credit union three years after notification of intent to withdraw. This option makes the membership capital considerably less permanent than ''core'' capital, since it is not controlled by the corporate credit union and is potentially short-lived. NCUA regards this form of capital to be distinctly different and less reliable than internally generated capital or paid-in capital with far longer or no maturity. Permitting corporates to place this form of secondary capital directly at risk substantially, and inappropriately, increases the risk of a crisis in membership confidence when losses do occur.

NCUA views the balance between core capital and risk-taking as essential if the corporate credit union network is to maintain and enhance its ability to withstand financial crises, whether limited to one institution or systemic in nature. This final rule is designed to strengthen core capital so that the corporate credit union network can better withstand financial stress without placing an inappropriate reliance upon its membership resources. Corporate credit unions should gradually reduce their reliance on secondary capital as core capital accumulates over time.

To bolster the accumulation of core capital, the proposed rule authorized the issuance of paid-in capital, defined as funds obtained from credit union and non credit union sources, having no maturity, and being callable only at the option of the corporate credit union and only if the corporate credit union meets its minimum level of required capital after the funds are called. Paid-in capital is included in the definition of NEV, thus giving corporate credit unions the option of raising permanent capital from their membership. Only a few commenters addressed paid-in capital. To make clear that paid-in capital is subordinate to membership capital, the definition has been modified and expanded in this final rule. The requirement that the funds have no maturity has been deleted.

The final rule distinguishes between ''member paid-in capital'' and ''non member paid-in capital.'' The former is held by the corporate credit union's members, has a minimum 20-year maturity, and may not be a condition of membership, services, or prices. Member paid-in capital may be retired prior to the stated maturity only when the corporate credit union elects to ''call'' the shares. Non member paid-in capital is sold to the outside marketplace and must be approved by NCUA. Most of the features of non member paid-in capital remain unspecified in the regulation so that issuance can be tailored to reflect prevailing market demands. The marketplace is the most efficient distribution mechanism for capital, as the market immediately determines the value and liquidity of an issue based on an issuer's performance and the perceived risk of the issue.

NCUA believes that paid-in capital should not be issued unless the corporate credit union can convince the market or its members that it will use the new capital to create new value. The members, like the marketplace, need to risk-adjust the expected return on paid-in capital and expect a fair return. A capital offering that serves to increase risk without increasing value is in no one's interest.

The proposed separate definitions for ''reserves'' and ''undivided earnings'' have been unified in the final rule as ''reserves and undivided earnings.'' The following proposed definitions have been deleted because the term is no longer used in the regulation or is so self-evident as not to require a definition: ''business day,'' ''commitment,'' ''forward rate agreement,'' ''futures contract,'' ''gains trading,'' ''material,'' ''maturity date,'' ''mortgage-backed security,'' ''option contract,'' ''primary dealer,'' ''private placement,'' ''reverse repurchase transaction,'' ''secured loan,'' ''swap agreement,'' tri-party contract,'' ''United States Government or its agencies,'' and ''United States Government sponsored corporations and enterprises.''

A few definitions that were not proposed have been added to the final rule, generally to accommodate the granting of certain additional investment authorities. Corporate credit unions may engage in the forward settlement of transactions beyond regular way settlement, under certain conditions, and definitions of ''forward settlement'' and ''regular way settlement'' have been provided. Corporate credit unions with additional authorities have been authorized to engage in dollar roll transactions and when-issued trading, and definitions of those activities have been provided.

Section 704.3—Corporate Credit Union Capital

The proposal required that a corporate credit union without expanded authorities have a capital, or leverage,

ratio of 4 percent. Most of the comments, with the notable exception of those submitted by banking associations, were supportive of the minimum leverage ratio of 4 percent. It is important to discuss the dissimilarities between corporate credit unions and banks to understand why the level of required capital should be different. Banks primarily use capital to support exposures to credit risk in the form of commercial and consumer loans. Corporate credit unions primarily use capital to support exposures to liquidity and interest rate risk associated with investment in money market instruments and fixed income securities.

Corporate credit unions presently provide a contingent liquidity resource for members at the same time they offer correspondent financial services. An overwhelming portion of a corporate credit union's business consists of providing banker's bank services and issuing shares and share certificates as investment alternatives for members' excess funds. Corporate credit unions are not, in practice, primary-lending institutions.

Capital adequacy is the central tenet of the proposed regulation. The type and amount of risk assumed were fully considered when capital ratios and corresponding risk limitations were developed. Since corporate credit union assets are predominantly high-grade investment securities, not loans, the regulation did not adopt a base leverage ratio target in excess of 4 percent.

Additionally, the rule has a number of triggers to measure the adequacy of capital in a corporate credit union. These triggers are related to market risk exposures as measured by NEV. Risk measures are required on a regular basis, not only for the contemporary market environment, but for stressed conditions as well. Similar to the other federal financial institution regulators, NCUA is requiring the development of risk management infrastructures which better measure and control risk.

The scope of these new requirements will vary by institution but will be commensurate with the amount of risk assumed and the degree of depth and sophistication employed to control these risks. This approach will facilitate a more appropriate control of risk and thereby establish a better early warning detection system when capital adequacy begins to deteriorate. Thus, the 4 percent minimum capital ratio is appropriate based upon the type of assets held and the rigorous risk-assessment requirements of the rule.

Using risk-weighted assets to produce a risk-based capital calculation has been debated throughout the Part 704 revision process. Proponents have argued that the calculation captures a meaningful measure of credit risk exposure which helps members and the public ascertain credit-risk trends in corporate credit union balance sheets. Corporate credit unions have high risk-weighted capital-to-asset ratios relative to other financial institutions, making the ratio a favorable measure for comparative purposes.

Opponents have argued that the risk-based capital calculation is too arbitrary in assigning credit risk weights and that the absence of consideration for interest rate risk makes the numbers misleading. The most recent proposal for changes to the interagency risk-based capital standards adjusts some credit risk weights and adds a new calculation for interest rate risk by adding weights for the duration of each asset. The calculation appears to be complex and potentially unwieldy while providing limited regulatory value where corporate credit unions are concerned.

NCUA advocates meaningful measures for credit and interest rate risk exposure expressed in relation to capital. Concentration limits, for example, have been converted from a function of net assets to one of core capital. While the risk-weighted asset approach is not utilized, conservative credit risk limitations are explicitly defined in the regulation and additional credit risk measurement and reporting requirements have been developed in the new credit risk management section, Section 704.6.

NCUA does not discourage corporate credit unions that desire to calculate the risk-weighted capital-to-assets ratio from doing so but would suggest that they adopt the same standard used by other financial institutions and understand that the calculation is not a regulatory requirement.

The proposed regulation provided authority for NCUA to impose a higher or lower minimum capital requirement on a case-by-case basis, with prior notice to the corporate credit union. Some commenters supported this authority, while others expressed concern that the regulation did not specify all of the circumstances in which it could be exercised. They suggested that it could be abused by NCUA.

The proposed rule illustrated four situations which might cause NCUA to require reserve levels other than those specified in the regulation. The first two were examples of circumstances that could require a higher level, while the last two were examples that could warrant a lower one. While NCUA would like to be able to clearly define every situation in which such actions could be taken, changes in market conditions and the corporate credit union environment make that impossible. Leaving the regulation open provides NCUA more flexibility in addressing unusual or non recurring events, including those which may result in a reduction in reserve levels.

It should be noted that NCUA already has the authority, under Section 116(b) of the Federal Credit Union Act, to adjust reserve requirements for federal corporate credit unions. This regulation will ensure that such authority is available for state-chartered corporate credit unions, in the rare event that it is needed.

To address concerns about NCUA abuse, the rule was amended so that NCUA may take action when significant risk exposure exists only when it is unsupported by adequate capital or risk management processes.

The proposed regulation also provided authority for NCUA to issue a capital directive when a corporate credit union fell below its minimum capital requirement and failed to submit or follow an adequate capital restoration plan. The directive could order a corporate credit union to achieve adequate capitalization by taking one or more of a number of actions, such as reducing dividends and limiting deposits. Some commenters objected to this authority, arguing that it would give NCUA management control over a corporate credit union. NCUA disputes that directing a corporate credit union to take certain specific actions to return to a safe and sound level of capital constitutes taking ''control'' of the institution. In addition, the authority in question is one held by the other federal financial institution regulators and, as with the authority to impose an individual minimum capital requirement, would be exercised only rarely. Accordingly, it has been retained in the final rule.

A number of commenters expressed concern that the NCUA Board would delegate its capital directive authority to NCUA staff. Several comments specifically objected to delegating this authority to examiners. Some commenters requested that the NCUA Board specifically state in the rule that this and other authorities could never be delegated to staff.

These comments reflect a lack of understanding of Board practice regarding administrative actions. While the Board has delegated some administrative actions to regional and office directors, none of the authorities can be redelegated to other staff

members, including examiners. Additionally, none of the actions delegated are final.

Delegated actions have been limited to preliminary actions, such as notices of charges and temporary cease and desist orders, which must go to the Board for final action.

The Board does not intend to delegate its authority to take administrative actions to examiners and never intended that any action proposed in Part 704 be delegated to examiners. However, this Board is unwilling to put into the regulation a restriction that would limit a future Board from taking an action it believed to be necessary.

Proposed Section 704.3 provided that when taking action in the case of a state-chartered corporate credit union, NCUA provide notice to the state supervisory authority. NCUA agrees with comments that notice should be provided when any action is contemplated, not just one relating to capital. To simplify the regulation, a general provision for consultation has been added to Section 704.17, governing state-chartered corporate credit unions, and individual provisions to that effect have been deleted. It should be noted that, contrary to the suggestion of one commenter, consultation does not mean that the state authority must give its approval before NCUA may act. In order to protect the share insurance fund, NCUA must have the authority to take action whenever safety and soundness demands it.

Section 704.4—Board Responsibilities

Proposed Section 704.4 required the board of directors of a corporate credit union to approve comprehensive written plans and policies and to oversee senior management to ensure these plans and policies are carried out. To emphasize the board's ultimate responsibility for the actions it delegates, the proposed rule stated, ''The board of directors must know and understand the activities, policies, and procedures of the corporate credit union.'' While this was not intended to turn directors into operating managers, a large number of commenters expressed concern about this requirement. To mitigate this concern, this sentence has been deleted from the final rule. NCUA is confident that board members will provided appropriate oversight if they recognize and meet their common law fiduciary responsibilities.

Some commenters objected to the proposed rule's requirement that a corporate credit union have in place, for all line support and audit areas, back-up personnel with adequate cross-training. To lessen the burden, the final rule allows for back-up resources rather than personnel, which means that corporate credit unions could temporarily support their operations with staff from other corporate credit unions or consulting firms.

Two commenters noted that the proposed requirement that a corporate credit union follow generally accepted accounting principles (GAAP) conflicts with the classification of credit union shares as equity. Since there may be other departures from GAAP in the future, the final rule requires that corporate credit unions follow GAAP, except where law or regulation has provided for a departure from GAAP.

Currently, the shares classification is the only departure.

Finally, a number of commenters questioned the proposed rule's requirement that a corporate credit union retain external consultants to review the adequacy of resources supporting major risk areas. To address these concerns, the final rule requires the retention of such consultants only as appropriate.

Section 704.5—Investments

The proposed rule inadvertently failed to require that a corporate credit union establish an investment policy. This requirement has been added to the final rule. The policy must be consistent with the corporate credit union's other risk management policies and must address, at a minimum, appropriate criteria for evaluating standard investments and risk analysis requirements for any new investment type or transaction considered for a corporate credit union's portfolio and/or sale to a member.

Certain commenters asked for clarification of the ''risk analysis requirements.''

This provision addresses the evolutionary nature of instruments in the financial marketplace. It is expected that new money market and fixed income securities will be created. Some of these securities may be legally permissible but may be distinctly different from the universe of instruments previously available. It is not possible to anticipate what additional analytical parameters, if any, must be employed before a product comes to market. Therefore, NCUA believes that policies must clearly indicate that the potential risks of new products, not unlike new services, must be carefully evaluated.

Many corporate credit unions engineer new certificate offerings that are structured to mirror specific investment assets. Such structured certificates effectively transfer the risk of the asset through to the holder of the certificate (the member).

Corporate credit unions need to ensure that the risk characteristics that are inherent, and perhaps unique, in a new investment type be sufficiently identified and rigorously analyzed before being purchased for its portfolio or marketed and sold to its members. A corporate credit union should not dictate what a member buys, but it should understand a new product's implications and be able to explain them to a member.

The proposed rule authorized investments in corporate credit unions and corporate credit union service organizations (CUSOs). One commenter asked that investments in wholesale corporate credit unions and CUSOs be specifically authorized. This is not necessary, as wholesale corporate credit unions are a subset of corporate credit unions and are included when the latter term is used.

The proposed rule established an NCUA-modified High Risk Security Test (HRST) for REMIC/CMO securities. The commenters on the test generally expressed two views. The first was to urge adoption of the standard Federal Financial Institutions Examination Council (FFIEC) parameters for the HRST so that the test would be consistent with those used by other depository institutions. The second was to drop the use of the HRST altogether based upon the assertion that proper NEV calculations would capture the risk of the underlying cash-flows and their corresponding price sensitivities anyway. These comments were about evenly divided. One commenter suggested that the proposed NCUA-modified tests be retained while another expressed that HRST tests should only be required if a corporate's NEV ratio fell below 1 percent.

NCUA is persuaded that the requirement to produce net interest income and NEV measures, set forth in Section 704.8, should be sufficient to evaluate the individual risk characteristics of all financial instruments, including CMOs/REMICs. Because all instruments will have to be individually modeled for plus and minus 300 basis point shifts, the HRST is effectively part of the risk measurement process already.

When appropriately modeling CMO/REMIC cash-flows in conjunction with the calculation of net interest income and NEV sensitivity, the HRST is redundant. The test is useful indication, however, of potential price volatility and liquidity risk. Bonds which pass the FFIEC test are regarded to have a

substantially greater universe of potential buyers. Given the liquidity priority of corporate credit unions, it makes sense to subject bonds to a periodic analysis of factors which will drive the market's bias towards such securities. By utilizing the test employed by other depository institutions, corporate credit unions gain useful insight into the contingent liquidity potential of individual CMO/REMIC securities.

Several commenters urged that the requirement to run a monthly HRST be changed to quarterly. NCUA agrees that if the net interest income and NEV tests are appropriately prepared in accordance with the rule, the HRST requirement is less significant and that quarterly testing will be adequate.

Some commenters suggested that the rule allow for the use of fewer prepayment models where the proposal called for at least three models. The reason that the rule required three or more models was to avoid the risk of ''cherry picking'' one favorable prepayment model to cause a CMO/REMIC to pass whenever possible. With the advent of simulation modeling requirements for net interest income and NEV, NCUA accepts that a more sophisticated corporate credit union will have the capacity to appropriately analyze the risk of a CMO/REMIC security with fewer than three prepayment models. Thus, the requirement that the board approve at least three prepayment models for CMOs/REMICs was removed from the Part I and Part II authorities but retained at the base level.

The proposed rule established identical standards for repurchase and securities lending transactions. One commenter noted that these are distinguishable economic and legal transactions and urged that they be separated in the regulation. NCUA agrees and effected that separation. The proposed rule required that collateral securities be legal for corporate credit unions, except that CMO/REMIC securities that passed the FFIEC HRST were permissible provided that the term of the transaction did not exceed 95 days. A number of commenters asked that the 95-day limit be dropped. The whole exception is unnecessary, now, with the substitution of the FFIEC HRST for the NCUA-modified test.

The proposed rule authorized investment in a registered investment company, provided that the portfolio of such investment company was restricted by its investment policy, changeable only if authorized by shareholder vote, solely to investments that were permissible for the corporate credit union making the investment. In response to comments, the shareholder vote restriction has been deleted.

As proposed, the final rule provided a grandfather clause, allowing corporate credit unions to continue to hold investments that were permissible when purchased but have become impermissible because of regulatory changes. One commenter stated that this was inconsistent with proposed Section 704.10, governing divestiture. That section requires divestiture of or a written plan to keep an investment that fails a requirement of Part 704. It should be understood that the grandfather provision supersedes the divestiture provision.

Section 704.6—Credit Risk Management

Most corporate and natural person credit unions recommended only minor revisions to the credit risk management section. Some, however, objected to the requirement of any credit due diligence, given that minimum credit ratings were limited to the top of the investment-grade range. Credit ratings obtained from nationally recognized statistical rating organizations are a significant tool for investors to evaluate credit risk associated with a specific security, issuer, guarantor, or provider of credit. They are no substitute for due diligence, however, and should be regarded as only one part of the credit risk management process.

Significant exposures to credit risk require extensive and continuous credit analysis by professionally trained staff. Managing a large credit exposure requires considerable personnel and financial resources, which many corporate credit unions do not possess. Expanded authority provisions allow for a broader spectrum of credit risk, and increased credit due diligence by corporate credit unions that obtain such authorities is key. Conversely, the amount of credit analysis conducted by institutions that operate at the base level and maintain very limited exposure to credit risk is not expected to be significant.

Credit risk exposure can be limited by restriction of counterparty, dollar amount, and/or maturity. Those corporate credit unions that remain at the base level and do not assume significant exposures should be able to achieve an adequate degree of credit risk management by employing a combination of these techniques. If a corporate credit union expands its tolerance for credit risk, it must increase its due diligence accordingly. That may mean hiring adequately trained staff and/or increasing the frequency and depth of review.

Several commenters suggested that specific concentration limits on repurchase agreements be removed from the regulation and left up to a corporate credit union's board of directors. The regulation allows corporate credit unions with expanded authorities to develop their own credit limits for these transactions based upon the additional depth and scope of their credit risk management. The base level was designed to accommodate institutions with restricted capacity to handle credit risk. The concentration limits are commensurate with the very limited due diligence expected to support low credit risk strategies.

One commenter requested that NCUA clearly state that it supported corporate credit unions using outside providers for investment and credit due diligence. The implication is that a CUSO or other third party provider could become the primary arbiter of the appropriateness and selection of investment assets. The desire of corporate credit unions to create cost-effective approaches to risk management is understandable, but outsourcing risk-management evaluations diminishes the control, independence, and accountability of risk making decisions.

While discretionary judgments can be outsourced, the board and management's accountability for investment decisions cannot be delegated, and the issue of credit risk becomes particularly complicated. For example, how would a CUSO, serving multiple institutions, determine how to equitably alert all clients to a declining credit which requires disposition? The sale of distressed financial instruments often accelerates market value declines (not inappropriately) leaving other investors with unsold positions at an increasing disadvantage. In other words, which client gets out first? In the event of material credit-related losses, who bears responsibility for the justification of the exposure and what recourse would affected clients have with a CUSO?

Aside from accountability issues, NCUA fears that a CUSO serving numerous corporate credit unions with credit risk research would significantly increase the potential for a crisis in the credit union system. The incidence of systemic crises is not uncommon for U.S. depository institutions. Occurrences are infrequent but typically severe, such as investments in Penn Square, where numerous corporate credit unions were simultaneously affected to a significant degree.

Another commenter urged that NCUA remove the specific reporting and documentation requirements. NCUA

developed this language to convey the minimum expectations for this important element of credit risk management. While modifications were made to this section to make it slightly more generalized, the need for some specificity was too critical to dismiss altogether.

Several commenters sought clarification on the credit risk management policy provision addressing concentrations of credit risk. The examples of concentration characteristics included in the regulation are ''industry type, sector type, and geographic.'' Commenters were concerned that NCUA would expect that all credit instruments be evaluated on the basis of a set list of concentration characteristics regardless of whether all of the characteristics applied to an individual instrument.

Examples were provided to indicate that there are a number of relevant concentration risks that can arise in the process of managing credit risk. Not all concentration types apply to all credit instruments. For example, a corporate credit union may need to consider whether a particular industry is disproportionately represented in its overall portfolio. To capture aggregate exposure, a corporate will need to summarize such concentration by reviewing across all transaction types.

Section 704.7—Lending

The proposed rule established limits on secured and unsecured loans to one member. A secured loan was defined to mean one in which the corporate credit union had perfected a security interest in the collateral. In response to comments, the requirement that the security interest be perfected has been deleted from the final rule. Further, exclusions have been added for loans secured by shares and marketable securities and for member reverse repurchase transactions.

The proposed rule required that a loan to a non credit union member be made in conformance with the member business loan rule. In response to comments, an exception has been provided for loans fully guaranteed by a credit union or credit unions. A few commenters suggested that corporate credit unions be permitted to participate with natural person credit unions in making loans to natural person members. In the past, NCUA was concerned that such activity could jeopardize a corporate credit union's banker's bank exemption from the Federal Reserve Board's Regulation D reserve requirements.

While NCUA believes that this area should be researched thoroughly, for several reasons, it will take no action now. First, the research necessary to analyze the potential impact of such loans would unnecessarily delay this final rule. In light of the few credit unions indicating interest, NCUA believes it more beneficial to finalize the rule and take the issue up at a later date. Second, if corporate credit unions were to participate in such loans, additional reserves would be necessary to cover the risk of default by natural persons. The public should have an opportunity to comment on such reserves before corporate credit unions are required to comply with them.

The NCUA Board has asked the Office of Corporate Credit Unions to study the issue and be prepared to make a recommendation when it provides its interim report to the Board 18 months after publication of this final rule.

Section 704.8—Asset and Liability Management

The proposed rule required a written asset and liability management (ALM) policy which addressed, among other things, the modeling of indexes that serve as references in financial instrument coupon formulas. Several commenters raised questions about this requirement. Many adjustable rate securities are available in the marketplace which have interest rate formulas linked to a number of reference rates, foreign currencies, and/or commodities. Corporate credit unions tend to buy variable rate securities which are linked to U.S. money market rates such as U.S. LIBOR or Fed Funds. Still others have purchased securities linked to constant maturity Treasuries (CMT), the Prime rate, or the 11th District Cost of Funds (COFI). It is important for an institution to evaluate the basis risk in such instruments to ensure that it has adequately measured the interest rate risk associated with the respective repricing behavior (vis-á-vis its cost of funds). The weaker the correlation between an index and the cost of funds, the greater the need to estimate the future behavior of the index.

The proposed rule required a corporate credit union to evaluate the risk in its balance sheet by measuring the impact of interest rate changes on its NEV and NEV ratio. A corporate credit union was required to limit its risk exposure to levels that did not result in an NEV ratio below 1 percent or a decline in NEV of more than 18 percent. The limit for corporate credit unions with Part I expanded authorities was 35 percent and for those with Part II authorities was 50 percent. Frequency of testing was a function of the NEV ratio. If NEV was 2 percent or above, testing had to be done quarterly. If it fell below 2 percent, monthly testing was required.

The proposed rule also required corporate credit unions with significant holdings of instruments with embedded options to perform additional testing beyond the 300 basis point parallel shift of the yield curve. The base test may not be sufficient to evaluate the potential risk to the balance sheet, particularly for those portfolios comprised of complex securities. Changes in the shape of the yield curve, shifts in the credit and liquidity risk premium reflected in spread changes, factors affecting prepayment speeds, and changes in volatility, will all have an impact. While the rule did not establish the testing frequency or the parameters to be used to evaluate the impact of these factors, it did require that the tests reflect these components of risk.

NCUA sought specific data from corporate credit unions to support the claim that a floor other than 1 percent was appropriate. It sought similar analytical support for challenges to the 18, 35, and 50 percent variation limits.

Most corporate credit union commenters pointed out that the minimum NEV ratio poses a major restriction on balance sheet growth even if such growth adds no incremental risk to the balance sheet. Commenters overwhelmingly supported keeping the minimum ratio at 1 percent of the fair value of assets, and some suggested removal of a minimum NEV ratio altogether. The vast majority of comments submitted were without supporting data. It is intuitive, however, that substantial growth in corporate credit union assets would exacerbate the risk of penetrating a floor of 2 percent or higher, since average core capital levels are presently between 2 percent and 3 percent of assets.

The use of a minimum NEV ratio is intended to establish a floor for primary capital which prevents a corporate credit union's core leverage ratio from falling dangerously low. It provides an estimate of the internal capacity of an institution to handle its risk exposures in the future and thus alerts the corporate credit union and NCUA to potential capital shortfalls.

Corporate credit unions have not historically had a growth inhibitor in the form of minimum capital ratios, and thus, the NEV ratio introduces a new element for management to control. While the NEV ratio does not indicate the nature or degree of risk that is inherent in a balance sheet, it does indicate the degree of leverage. Capital is the reserve of funds available to manage all the risks of the institution,

including those which are not part of the risks associated with changes in interest rates.

Measuring risk is an imprecise business because of the multitude of assumptions that are required to evaluate potential outcomes. NCUA believes that an NEV ratio below 1 percent would be imprudent because little room would remain for errors in measurement or for the potential confluence of business risks. An NEV ratio of 1 percent will provide a reasonable early-warning detection mechanism for capital inadequacy. The present levels of capital would not permit a substantially higher floor at this time without a risk of forced shrinkage in corporate credit union balance sheets.

Consistent with the base level thresholds established in the credit risk management section, an 18 percent NEV volatility limit is adopted to set a conservative market risk limit for corporate credit unions that do not possess the financial, system, or personnel resources to support a significant market-risk earnings strategy. The 18 percent limit allows corporate credit unions at the base authority level to entertain a modest mismatch between liabilities and assets (overnight and/or term) and capital investments inside of seven years.

NEV is an imperfect measure in the sense that it portrays the risk inherent in the balance sheet as one number. It is a present value of the asset cash-flows less a present value of the liability cash-flows plus/minus the time value of any embedded options. NEV does not indicate when the risk will occur but it does indicate the aggregate amount of potential risk. Used in conjunction with income simulation (a short-term view of risk), NEV provides a good method for simultaneously managing the earnings and net worth of an institution.

It is expected that corporate credit unions will have some degree of mismatch in the normal course of business because member demands for amount and maturity on the liability side of the balance sheet do not perfectly correlate to available market instruments on the asset side. The NEV calculations will capture the aggregate market risk and permit corporate credit unions, no matter how their respective mismatches are structured, to convey risk in a relatively simple and consistent manner.

An NEV volatility limit of 18 percent was criticized by many commenters as being too low and ''essentially a matched book.'' Any NEV variance can be achieved with a total matched book in place since the duration of the asset purchased with capital (not matched) will determine the net risk. If capital is invested in short duration instruments, the NEV volatility will be correspondingly low. If capital is invested in long duration instruments, the volatility will be higher. There is no precise level of NEV that equates to a ''matched book.'' The 18 percent NEV limit is the same as a net risk position with a price sensitivity equal to that of seven year zero-coupon Treasury bond. This is not an insignificant amount of market risk. It is a corporate credit union's choice whether it takes that risk in an overnight account or whether it spreads it out among various books of business (overnight, term, capital, etc.). Some institutions may choose to run matched books and take all the risk with their capital. Regardless, the maximum decline will be limited to 18 percent of base case NEV.

One aspect of using NEV which must be noted is the effect of negative convexity. Two corporate credit unions may have an equivalent net risk exposure at a given point in time, but the respective exposures will change very differently with subsequent changes in market factors, depending on the composition of assets. One may choose to take the bulk of its mismatch in the overnight account using optionless money market instruments and invest its capital in a medium-maturity debenture. The other may incur a mismatch by buying low duration floating rate securities which possess a considerable amount of option and basis risk.

In the first example, the sensitivity of NEV is fairly constant and the risk profile may be altered relatively quickly with the passage of time (by letting short maturities roll into overnight). In the latter example, the option and basis risk may not emerge until the interest rate environment has changed. Because securities with call, prepayment, and cap options can extend dramatically, it is possible for such a portfolio to go from a sensitivity of 18 percent to an exposure many times that amount in a short time as the institution calibrates its rate shocks to a new plus and minus 3 percent range.

Several corporate commenters suggested that an interim operating level be considered for moderate capacity corporates, consisting of an NEV volatility limit of 25 percent, with no additional investment or credit authorities. They argued that the cost of building a risk management infrastructure was essentially a barrier to entry for expanded authorities, and they viewed the higher NEV limit as a mechanism for funding the incremental costs of getting there. To compensate for the incrementally greater risk, the commenters suggested that qualifying corporate credit unions conduct the rate shock tests monthly, as opposed to quarterly, and that they also conduct the additional tests, beyond the 300 basis point parallel shift of the yield curve, regardless of their holdings of instruments with embedded options.

NCUA agrees that select corporate credit unions are capable of operating between the base and Part I limits, and has created a ''base-plus'' level. With NCUA approval, an institution can operate with an NEV volatility of 25 percent provided that it performs additional tests and has additional management and infrastructure. NCUA will assess the institution to verify that the incremental qualifications are resident. For example, more than one senior manager will be expected to have strong knowledge of investments and ALM. In addition to risk measurement, the ability for the institution to withstand the departure of a key staff member and the ability to achieve adequate separation between risk takers and risk monitors will be important.

Corporate credit unions qualifying for a 25 percent NEV variance will be expected to conduct risk modeling with greater vigilance than those operating with an 18 percent variance, and such institutions must establish commensurate policies, procedures, and internal controls. NCUA will expect corporate credit unions that qualify for a 25 percent NEV limit to demonstrate a greater ability and inclination to aggressively respond to adverse market developments than base authority institutions. Operating with an NEV volatility of 25 percent may increase current earnings, but it also raises the probability of experiencing future losses.

For corporate credit unions that want to run bigger mismatches, the Part I expanded authorities doubles the amount of permitted market risk from the base, allowing an NEV decline of 35 percent. This degree of mismatch has the aggregate risk sensitivity of a 15 year zero-coupon Treasury bond. Part II expanded authorities allows an NEV decline of 50 percent, equating to an aggregate risk sensitivity of a 24 year zero-coupon bond. The following table shows the risk sensitivities of zero-coupon bonds of various durations.

PRICE SENSITIVITY OF ZERO-COUPON TREASURY BONDS

[Prices as of 01/08/97]

Investment (years)	Price sensitivity +2% shock (percent)	Price sensitivity +3% shock (percent)
7	·13	·18
10	·18	·25
15	·26	·36
24	·38	·51

Source: Bloomberg; S <Govt>, TRA(O).

NCUA has allowed sophisticated and well-developed corporate credit unions to take much greater market risk than that permitted for institutions with base authorities. If a corporate credit union wishes to make market timing a substantial portion of its earnings strategy, the expanded authority levels provide ample room for managing sizable mismatches between assets and liabilities. But, at the base level, the rule must have prudent limitations on market risk that reflect the more limited capacity of many smaller and/or more conservative institutions which cannot afford or do not desire to commit the financial and personnel resources to build the appropriate risk-taking infrastructure that is required to support higher NEV volatility.

The base level is intended to establish a conservative territory where even the smallest and most thinly developed corporate credit union can continue to provide standard products and services without being subject to imprudent risks or burdened with excessive infrastructure costs. In order for the regulation to encompass the full spectrum of corporate credit unions, it must provide both a minimum safety and soundness barrier as well as a mechanism for expanding opportunities (commensurate with an increasing capacity to manage risk). The rule is structured to create distinctive operating classifications in response to the widely diverse corporate credit union network.

A number of commenters noted that NCUA was adopting specific limits on interest rate risk where other federal financial institution regulators have elected to handle it through supervision. NCUA acknowledges this difference but disagrees with the notion that its approach is inconsistent or inappropriate.

Corporate credit unions comprise a relatively small private financial network which serves a finite universe of members. The credit union system cannot afford the failure of a corporate credit union, whereas the failure of an individual bank or thrift is less consequential to the survival of all other banks and thrifts. Because of these differences, NCUA believes that explicit measures of risk tolerances are appropriate.

In addition, many corporate credit unions are making a transition from a traditional strategy where little interest rate risk was taken (achieved through maturity and rate-reset matching of assets and liabilities) to a strategy which assumes a variety of intentional market risk mismatches, including maturity, option, and basis risk. Explicit risk measures are essential in such an environment.

One corporate credit union commenter, joined by a number of its member credit unions, claimed that the rule encourages corporate credit unions to take credit risk as opposed to interest rate risk. This sentiment is troubling. The proposed rule is intended to promote and reinforce the discipline of comprehensive risk management, regardless of the risk type assumed.

If a corporate credit union intends to entertain significant exposures to market, credit, and/or liquidity risk in order to generate its spread income, the obligation to professionally control those risks is substantial. The expanded authority concept is predicated on the idea that professional risk taking must be supported by a state-of-the-art risk management infrastructure.

Section 704.9—Liquidity Management

Relatively few comments were received on this section of the proposed rule. However, in response to those comments, the rule has been amended so that a corporate credit union need only monitor its liquidity sources regularly, rather than continuously, and need not necessarily test its external lines to ensure that contingent sources of liquidity remain available. However, a corporate credit union must be able to demonstrate, whether through testing, written confirmation, or other means, that such sources remain available.

Section 704.10—Divestiture

Few comments were received on this section of the proposed rule, and except for changes to time frames to standardize them with others in the regulation and the addition of the supervisory committee to the list of entities which must receive a failed investment report, no changes have been made in the final rule.

Section 704.11—Corporate Credit Union Service Organizations (Corporate CUSOs)

The proposed rule defined a corporate CUSO as an entity that: (1) Has received a loan from and/or is at least partly owned by a corporate credit union; (2) primarily serves credit unions; (3) restricts its services to those related to the daily activities of credit unions; and (4) is chartered as a corporation under state law. A number of commenters pointed out that defining an entity that has received a loan from a corporate credit union as a corporate CUSO would severely restrict the ability of corporate credit unions to lend to natural person CUSOs. This was not intended, and that portion of the definition has been deleted.

Some commenters expressed concern that the restriction of services to those related to the daily activities of credit unions might unduly limit the activities of corporate CUSOs, since a legitimate activity might not occur every day. It was not the intent of the proposed rule to require that an activity occur every day; however, to allay concerns, the final rule requires that services be related to the normal course of business of credit unions.

In response to comments, the rule has been amended to permit corporate CUSOs to be structured as limited liability companies or limited partnerships, as well as corporations. NCUA agrees that these forms are appropriate for corporate CUSOs. Also in response to comments, the conflict of interest provision has been amended to permit a corporate credit union to share employees with a corporate CUSO. NCUA was persuaded that there is a legitimate business purpose for such an arrangement. However, such arrangements will be scrutinized to ensure there is no insider self-dealing. Further, the rule still prohibits corporate credit union directors and committee members from receiving compensation from a corporate CUSO.

Section 704.12—Services

Few comments were received on this section, and it is unchanged in the final rule. This section was intended to protect the integrity of federal corporate credit union fields of membership. However, should NCUA authorize national fields of membership for federal corporate credit unions, there may be a determination to eliminate this section at a future date.

Section 704.13—Fixed Assets

As proposed, the final rule permits a corporate credit union to invest in fixed assets where the aggregate of all such investments does not exceed 15 percent of the corporate credit union's capital. In response to one comment, NCUA wishes to clarify that the 15 percent refers to book value. As proposed, the final rule provides for a corporate credit

union to request a waiver of the limitation from NCUA. The proposed rule eliminated the current provision that allows a corporate credit union to proceed with its investment if it does not receive notification of the action taken on its request within 45 days. Three commenters objected to NCUA not having a deadline to respond, and the 45 day timeframe has been reinstated.

Section 704.14—Representation

The first proposal to revise Part 704, issued in 1995, amended the representation section to provide that only representatives of member credit unions were permitted to vote and stand for election. This involved changes to a number of paragraphs. When the proposed revision to Part 704 was reissued in 1996, NCUA determined not to go forward with the member-only proposal and intended to reverse all of the changes that had been made in that regard. Inadvertently, some of the changes were left in place. The final rule corrects this error.

Section 704.15—Audit Requirements

In response to the few comments received on this section, the language has been clarified and made more consistent with auditing terminology.

Section 704.16—Contracts/Written Agreements

No changes were made to this provision.

Section 704.17—State-Chartered Corporate Credit Unions

As noted earlier, a paragraph has been added which provides that NCUA will consult with the state supervisory authority before taking administrative action against a state-chartered corporate credit union.

Section 704.18—Fidelity Bond Coverage

In response to comments, the calculation of minimum bond has been clarified and a $5 million cap has been added to each category in the maximum deductible table.

Section 704.19—Wholesale Corporate Credit Unions

The commenters generally supported this section, and it has been retained as proposed.

Appendix A—Model Forms

Some changes have been made to Sample Form 2 in the final rule to accommodate the changes to the definition of paid-in capital.

Appendix B—Expanded Authorities and Requirements

The proposed rule introduced a multi-tier approach to the regulation of corporate credit unions. Proposed Appendix B set forth incrementally greater authorities for corporate credit unions and the infrastructure and capital requirements that were required to be in place to obtain such authorities. The commenters supported the multi-tier approach, and it has been retained in the final rule. Based on the comments received, several additional authorities have been added to Parts I and II. So that NCUA can effectively supervise the transition to this final rule, each corporate credit union is asked to inform NCUA, by April 15, 1997, of its initial decision regarding the level at which it wishes to operate.

One commenter thought that all investments should be grandfathered in a case where a corporate has its expanded authorities revoked. This observation raises an important issue. The final rule will shift the major focus of risk evaluation from individual financial instruments towards an aggregate or ''balance sheet'' risk assessment. While individual securities and transactions might be grandfathered from automatic divestiture, the revocation of expanded authorities would likely be precipitated by concerns about the overall risk profile of that institution. While individual transactions will not necessarily be singled out, a corporate credit union must be prepared to employ asset disposition to reduce excessive risk when exposures warrant.

For example, a substantial weakness in internal controls and/or major capital inadequacy would necessitate a reduction in risk. If expanded authorities are regarded to be adding risk to an already unacceptable exposure, then NCUA would have to consider a revocation of the authorities. This could prompt NCUA to mandate a risk reduction strategy that requires the institution to adopt asset disposition in order to achieve an appropriate and timely risk reduction. Once revocation occurs, any additional expanded-authority activities will cease and NCUA will evaluate, based on the unique circumstances, what corrective actions are necessary. Thus, while the rule does not predetermine the sale of specific expanded-authority transactions, forbearance from divestiture will not be assured.

Proposed Appendix C set forth guidelines for evaluating requests for expanded authorities. In response to the comments received, these guidelines have been removed from the regulation and put into a handbook format. Consequently, Appendix C has been deleted. The guidelines will be provided to all corporate credit unions.

Part 709—Involuntary Liquidation and Creditor Claims

No comments were received on this section, and it has been retained in the final rule.

Part 741—Requirements for Insurance

No comments were received on this section, and it has been retained in the final rule.

C. Regulatory Procedures

Regulatory Flexibility Act

NCUA certifies that the proposed rule, if made final, will not have a significant economic impact on small credit unions (those under $1 million in assets). The rule applies only to corporate credit unions, all of which have assets well in excess of $1 million. Accordingly, a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

The reporting requirements in Part 704 have been submitted to and approved by the Office of Management and Budget under OMB control number 3133–0129. Under the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The control number will be displayed in the table at 12 CFR Part 795.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. It states that: ''Federal action limiting the policy-making discretion of the states should be taken only where constitutional authority for the action is clear and certain, and the national activity is necessitated by the presence of a problem of national scope.'' The risk of loss to federally insured credit unions and the NCUSIF caused by actions of corporate credit unions are concerns of national scope. The final rule will help assure that proper safeguards are in place to ensure the safety and soundness of corporate credit unions.

The rule applies to all corporate credit unions that accept funds from federally insured credit unions. NCUA believes that the protection of such credit unions, and ultimately the NCUSIF, warrants application of the proposed rule to non federally insured corporate credit unions. NCUA, pursuant to Executive Order 12612, has determined

that this rule may have an occasional direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. However, the potential risk to the NCUSIF without these changes justifies them.

List of Subjects

12 CFR Part 704

Credit unions, Reporting and recordkeeping requirements, Surety bonds.

12 CFR Part 709

Claims, Credit unions, Liquidation.

12 CFR Part 741

Bank deposit insurance, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on March 7, 1997.

Becky Baker,

Secretary of the Board.